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EUROPEAN CONSUMER PROTECTION**

A blank cheque for unfairness?

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Abstract

This contribution takes a close look at overdraft facilities, the most eccentric type of credit under the scope of Directive 2008/48 EC on credit agreements for consumers. Even in the absence of a ‘smoking gun’ linking consumer credit to personal insolvency, the tacit nature of this type of credit represents a significant “spiral of debts” risk. Armed with some overdraft facility basics we provide several theoretical insights on imperfect markets for consumer finance and consumer (un)awareness and biases when contracting for money. Today’s information requirements only partly capture the reality of *Homo sapiens* kind of borrowers. European consumer protection ought to safeguard consumers from behaviour diverging from (perfect) rationality. It should therefore abandon narrow legal reasoning and include ethical, economical and social norms. In an attempt to reach a substantial information equilibrium we call for multi-layered and intelligent credit regulation incorporating aforementioned behavioural evidence. While such rules might be better aligned with product legislation, new IT solutions pave the way for targeted point of sale disclosure and tailored monthly statements. A strict regulatory dichotomy between regulation with regard to a consumer’s assets (e.g. investor protection) and debts (e.g. consumer credit) seems superseded. The last part of our contribution shines a light on the evolved Belgian approach with regard to overdraft facilities, foreclosing an unlimited freedom of the market for price setting.



INTRODUCTION

The aim of the present contribution is to investigate to which extent European consumer legislation is an adequate means to tackle potential unfairness regarding overdraft charges, i.e. *the price charged for funds made available to consumers which exceed the current balance of their account*.¹ Credit facilities that give rise to such charges are offered by both financial- & non-financial institutions and are often accompanied with a credit card that allows its holder to make cash withdrawals and purchase goods or services. As long as there are sufficient funds on the cardholder's account, the consumer only makes use of the card's "transaction function" while withdrawing money or purchasing goods or services. If on the other hand, the funds on the consumer's account are insufficient to repay the amount as indicated on the monthly statement², the consumer uses the card simultaneously to *transact* and to *borrow*. The latter might occur unintentionally, often even unconsciously.³

The importance of overdraft services couldn't be overestimated. In Belgium (a country with a population of around 10.5 million) for example, almost 494. 000 new contracts of this type were registered last year, good for nearly one third of all consumer credits registered.⁴ The total number of registered overdraft facilities amounts up to € 3.85 million.⁵ Without doubt, overdraft facilities and credit cards fulfil an important distributive function between economic agents, crucial for modern economies. Both certainly democratized consumers' access to credit⁶ and contributed⁷ to the creation of a smooth functioning internal market.⁸ One should however not be indifferent for the 'spiral of debt' risk of this type of credit.⁹ Substitution of income by credit seems more and more to become 'a way of life' for a great number of consumers.¹⁰

While the number of credit card transactions per capita in most European Member States is declining, Belgian consumers increasingly use credit cards for *routine transactions*.¹¹ The fact that overdraft borrowers are barely hindered by tangible limits to purchase might jeopardize the financial health of numerous households.¹² Again in 2009, more than 3 million

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¹ Article 3 (d) Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for consumers and repealing Council Directive 87/102/EEC (hereinafter 'Consumer Credit Directive' or CCD) provides such definition.

² Or if spending exceed a consumer's current balance in case of an overdraft facility linked to an debit card.

³ Given the tacit nature of overdraft credit, a consumer might overdraw his account without knowing. A survey of the Office of Fair Trading revealed that merely 7 percent of the UK's current account holders participating in the survey deliberately overdraw their personal current account. See OFFICE OF FAIR TRADING, 'Personal current accounts in the UK. An OFT market study.', 2008, available at www.fsa.com

⁴ See the 2009 Statistics from Central Individual Credit Register, a branch from the National Bank of Belgium, page 19. This information is online available at www.nbb.be/pub. One should bear in mind that not all credit facilities have to be registered at the Central Individual Credit Register (since registration is only required for credits exceeding a minimum amount of credit). The actual number might therefore be even significantly higher.

⁵ See the 2009 Statistics from Central Individual Credit Register, page 27.

⁶ See D. EVANS and R. SCHAMLENSEE, *Paying with plastic: The Digital Revolution in Buying and Borrowing*, Cambridge, MIT Press, 1999; and T. BROWN and L. PLACHE, 'Paying with Plastic: Maybe Not So Crazy', *Chi. L. Rev.*(Chicago Law Review), Vol. 73, 73. Borrowers with a bad credit history face lesser barriers as would be the case with other forms of consumer credit, when borrowing through an overdraft facility.

⁷ This contribution should mainly be situated before the creation of a Single Euro Payments Area. See R. STEENNOT, 'The Single Euro Payments Area (SEPA) and the Payment Services Directive (PSD)', *European Journal of Consumer Law*, 84.

⁸ It should be stressed here that cross-border credit activity is very limited in the European Union. No 'single market for 500 million borrowers' exists. See DG HEALTH AND CONSUMER PROTECTION, 'Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection. Final Report', November 2009, 39.

⁹ S. ISSARACHOFF and E. F. DELANEY, 'Credit Card Accountability', *Chi. L. Rev.*, Vol. 73, 157.

¹⁰ See about this leverage: O. BAR-GILL, 'Seduction by Plastic', 98 *Nw. U. L. REV.* (Northwestern University Law Review), 1373.

¹¹ See press release Atos Worldline Belgium, a private company providing electronic transaction services, from the 25th of January 2010 (see <http://www.atosworldline.be>). The press release learns that in Belgium 129 million credit card transactions were processed in 2009, good for an average of one monthly credit card transaction for every Belgian Citizen.

¹² Financial distress is not merely an individual problem for the borrower. Great externalities can be monitored here. See further nr. 30. Some scholars rightfully asses that Directive 2008/48/EC barely addresses the social-cost of excessive borrowing, resulting in over-indebted



'Belgian' facilities carried overdue debt with them, good for almost 45% of all credit contracts carrying overdue debt and little enviable, an outspoken leadership among the different types of credit.¹³ Alarming is moreover that the tacit nature of this type of credit especially threatens financial inexperienced consumers.¹⁴ Recent studies about financial literacy reveal that a greater part of the European consumers lacks competence to understand some basics of modern finance.¹⁵

Such findings raise numerous questions about the aptness of the current European Consumer Legislation to protect financial consumers, as it is often based on today's dominating information paradigm. In short, this technique deems to protect consumers by giving them sufficient information about the goods or services they (wish to) purchase. Little attention is given however to the substantive aspects of the prescribed information, despite outcomes of earlier mentioned financial literacy studies. Further research reveals that besides the *capacity*, consumers often also lack the *interest* in gaining basic knowledge about the terms of financial services or products.¹⁶ They simply seem not to bother and fail to read the (mass of) documentation produced by financial institutions¹⁷, which fulfil their obligation to disclose and 'sign without reading'.¹⁸ Finally, even in a world without financial ignorance, the ability to protect by giving information remains food for discussion between academic scholars.

As the dust slowly settles down on the financial markets, time has come for thorough reflexion about the consequences of this crisis for the current Financial Architecture, including the protection of financial consumers. Recent history thought convincingly that a run aground of financial relations on a micro-level bears the risk of expanding to the macro-level, thereby possibly inflicting systemic risks.¹⁹ The foundation of a healthy financial system lies therefore equally in a solid financial understanding on the micro-level.²⁰ An understanding, among other things, of the price of financial services as a major determinant for consumers' welfare.²¹ While focussing on overdraft facilities, the scope of this fundamental question largely exceeds this particular credit relation. Readers are therefore not

households. See for example: I. RAMSAY, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets*, Oxford-Portland (Oregon), Hart Publishing, 2007, 40.

¹³ See the 2009 Statistics from Central Individual Credit Register, page 20.

¹⁴ WONDER, WILHELM and FEWINGS correctly observe that there is no level playing field with regard to financial welfare. Whereas educated borrowers tend to make better loan decisions their less educated colleagues, even those with a college-degree face problems to understand complex loan documentation. See N. WONDER, W. WILHELM and D. FEWINGS, 'The Financial Rationality of Consumer Loan Choices: Revealed Preferences Concerning Interest Rates, Down Payments, Contract Length, and Rebates', *The Journal of Consumer Affairs*, Vol. 42, Nr. 2, 268-269.

¹⁵ The lack of financial intelligence is, contrary to Mifid Regulation, no criterion that imposes a duty on the supplier of financial services to refrain from transacting and this notwithstanding the fact that downsides credit risks might exceed the risk for a consumer when investing. See number

¹⁶ H. LUTH refers in this context to 'rational apathy' or a rational choice to be uninformed. The term originates from political science. See: H. A. LUTH, 'Extending the scope of the Unfair Terms discipline in consumer contracts- an economic and behavioural perspective', *Rotterdam Institute of Law and Economics Working Paper Series*, No 2008/01, 3.

¹⁷ SCHILLIG rightly ascertains that 'rational apathy' also affects sophisticated market participants such as for example law professors and lawyers, who generally won't re-negotiate standard terms when purchasing goods and services. See M. SCHILLIG, 'Inequality of bargaining power versus market or lemons: Legal paradigm change and the Court of Justice's jurisprudence on Directive 93/13 on unfair contract terms', *E.L. Rev. (European Law Review)*, June 2008, 339.

¹⁸ See G. De GEEST, 'The Signing-Without-Reading Problem: An analysis of the European Directive on Unfair Contract Terms', In H.-B. SCHÄFER & H.-J. LWOWSKI (eds.), *Konsequenzen wirtschaftsrechtlicher Normen*, 213.

¹⁹ Or as a former lawyer from Chicago puts it: 'Abuses like these [referring to abuses in the market for consumer credit] don't just jeopardize the financial well-being of individual Americans – they can threaten the stability of the entire economy'. Remarks by President BARACK OBAMA on Consumer Financial Protection, October 2009, 2:37 PM EDT. The market for consumer credit equals 10% of the European GDP, practices affecting the sector's health evidently could harm the European economy as a whole. See for example E.F. GERDING, 'The Subprime Crisis and the Link Between Consumer Financial Protection and Systemic Risk', *Florida International University Law Review*, 2009. In his book, MANN recalls how default situations on the micro-level, for example a default of nearly 12 million credit card holders, led to a billion dollar bailout of credit card companies by the South-Korean government. See R. J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006.

²⁰ At the end of 2008, Americans' credit card debt reached \$972.73 billion. Obviously one should be careful when drawing parallels between credit (card) debt across the Atlantic.

²¹ DG HEALTH AND CONSUMER PROTECTION, 'Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection. Final Report', November 2009, 8.



only invited to apply theories and reasoning on themselves but also to link them - where relevant - with other (financial) agreements.

Armed with some overdraft facility basics, we proceed this contribution with an attempt to provide some insights about consumer (un)awareness and biases when contracting for money (part I). Before analyzing more substantive instruments of EC consumer protection, part II explores several boundaries of information disclosure as a - soft paternalistic - tool to protect financial consumers. As we will see, the fairness of terms relating the price as well as terms regarding the essential obligations of the parties under an agreement is not encompassed under Directive 93/13/EEC, the single most important European instrument governing unfair contract terms, nor under its successor, the Proposal for a Directive on Consumer Rights. This exclusion derives from the idea that in a free market economy, it belongs to the parties and not a legislator, nor a judge, to shape or reshape the principal obligations of an agreement. In part III we will outline the plain and intelligible language requirement of this so-called “core exclusions”. Before pleading for a –European²²- solution to tackle some of the aforementioned issues, the fourth part of our contribution shines a light on the evolved Belgian approach with regard to negative balances on a current account, foreclosing an *unlimited* freedom of the market for price setting.²³

I. OVERDRAFT FACILITIES AND FAIRNESS: A THEORETICAL APPROACH

1. **INTRODUCTION.** In this first part we discuss some cornerstones of consumer finance. A concise background of overdraft facilities and certain theoretical elements underlying this type of credit is essential for any attempt of legal analysis. If consumer credit is much more heavily regulated than other (consumer) contracts, this occurred not without reason.²⁴ Before assessing the aptness of several legal avenues in this field (part II-IV) we investigate their *raison d'être*. Not merely consumer advocates and journalists seem to show a keen interest in this subject. The academic literature - both theoretical and empirical - on credit (facilities) and credit cards is extensive. In an attempt to reveal how policymakers could steer individuals' behaviour in relation with (this particular form of) consumer finance, we provide an outline of theories regarding such behaviour.²⁵ After some overdraft facility essentials (section A), section B focuses on evidence suggesting troubled *markets* for consumer credit.²⁶ Section C draws the attention on some *behavioural insights* on consumer biases and heuristics, explaining consumer choice when contracting for money. Before concluding this theoretical part with an evaluation of the theory of equal bargaining power between creditors and consumers (section E), we assess the relation between overdraft facilities and over-indebtedness (section D).

(A) Overdraft facilities for dummies.

²² After providing the reader with evidence about the ‘European character of this problem’, we shall argue that a European legal solution in this field is recommended since other –national- legal avenues bear the risk of regulatory arbitration in favour of safe havens or European Member States with a less protective legal framework. Notwithstanding such race to a less-protective legal regime, problems with regard over-indebtedness will remain largely national. In the United-States a Supreme-court decision in *Marquette National Bank v. First Omaha Service Corp.* opened in 1978 the gates for regulatory arbitration with regard to credit cards. See S. ISSARACHOFF and E. F. DELANEY, ‘Credit Card Accountability’, *Chi. L. Rev.*, Vol. 73, 159.

²³ From December 2010, both the Belgian Law of July 14 1998 as the Law of May 14 2001 will be abolished and included in the ‘new’ Belgian Consumer Credit Code as adapted by the Law of June 13 2010.

²⁴ R. M. HYNES and E. A. POSNER, ‘The Law and Economics of Consumer Finance’, *John. M. Olin Law & Economics Working Paper No. 117* (2nd Series), February 20, 2001, available at <http://ssrn.com>.

²⁵ See for a ‘founding contribution’: C. JOLLS, C. R. SUNSTEIN and R. THALER, ‘A Behavioral Approach to Law and Economics’, *Stan. L. Rev.* (Stanford Law Review), Vol. 50.

²⁶ Behavioural law and economics tries to *enforce* the predictive power of classic law and economics theory by suggesting that people have limited computational skills, imperfect memories and human behaviour therefore is not always perfectly rational, but nevertheless predictable, since divergence with the classic model is systematic. See C. JOLLS, C. R. SUNSTEIN and R. THALER, ‘A Behavioral Approach to Law and Economics’, *Stan. L. Rev.*, Vol. 50, 1475.



2. **OVERDRAFT WHAT? ACQUAINTANCE WITH A PARTICULAR TYPE OF CREDIT.** An overdraft facility²⁷ (“*ouverture de crédit*”) can be described as an *explicit* credit agreement whereby a creditor makes available to a consumer funds which exceed the current balance in the consumer’s current account.²⁸ The facility grants a debtor the *option*²⁹ to draw cheques on his account, to make cash withdrawals or payments, even when having insufficient funds on this account.³⁰ Borrowers are allowed to use as much of the facility as they require up to a certain contractual agreed limit or ‘ceiling’.³¹ If one exceeds this limit, an “unarranged overdraft” (or ‘overrunning’) occurs.³² Unlike “close-end” types of credit, some crucial parameters of the loan are not decided on up-front.

3. The price a consumer will have to pay for this type of credit therefore depends – besides any variability of interest rates - on the use-pattern of the facility.³³ Debit balances are likely to be subject of continuous fluctuation, e.g. in response of volatile income or expenses. Once repaid, one can draw down the credit again (revolving character).³⁴ Overdraft facilities could be open-end agreements, could be granted for a specific period of time or be ‘repayable at call’ which obliges the debtor to repay the overdraft in case of realization of particular events specified in the credit agreement.³⁵ In Belgium, nearly all overdraft facilities are open-end agreements.³⁶ Overdraft facilities are often included in the standard personal account packages that financial institutions offer their clients, as a possibility to *overrun* their current balance.³⁷ Consumers may even be required to tick a small box if they *don’t desire* an overdraft facility to be linked to their current account.³⁸ Whether the consumer’s consent to such an overdraft facility always corresponds with the notion of an ‘explicit’ credit agreement as the Consumer Credit Directive’s definition leads one to suspect is questionable. As indicated before overdraft services are increasingly offered by non-financial institutions, often brokering for a financial organisation in the capacity of credit intermediary.³⁹ One can

²⁷ Also referred to as: ‘credit line’, ‘cash reserve’, ‘comfort loan’, ‘budget line’, ‘cash facility’. etc.

²⁸ Article 3 (d) Consumer credit directive. In the Belgian Consumer Credit Act overdraft facilities article 1, 12° defines overdraft facilities as: ‘*tout contrat de crédit, quelle que soit sa qualification ou sa forme, aux termes duquel un pouvoir d’achat, une somme d’argent ou tout autre moyen de paiement est mis à la disposition du consommateur, qui peut l’utiliser en faisant un ou plusieurs prélèvements de crédit notamment à l’aide d’un instrument de paiement ou d’une autre manière, et qui s’engage à rembourser selon les conditions convenues*’ or ‘*every credit agreement, irrespective of its form, that puts purchasing power, money or any other means of payment at a consumer’s disposal, who can use it by taking up credit once or more, among other things by means of a payment or legitimization card, or by other means and who commits himself to repay the amount borrowed as agreed*’.

²⁹ See Part F Book IV-1:101 Scope Draft Common Frame of Reference. Part F of the DCFR is however **not** applicable to loan contracts between a business and a consumer.

³⁰ E. ELLINGER, E. LOMNICKA and R.J.A. HOOLEY, *Ellinger’s Modern Banking Law* (fourth edition), Oxford, Oxford university press, 2005, 689.

³¹ A. HUDSON, *The law of finance* (first edition), London, Sweet & Maxwell, 2009, 866.

³² Article 3 (e) Consumer credit directive defines this as ‘overrunning’, or a tacitly accepted overdraft whereby a creditor makes available to a consumer funds which exceed the current balance in the consumer’s current account *or overdraft facility*. The consumer has no right to such overdraft and has to bring his account back to the agreed level a.s.a.p.

³³ H. A LUTH, ‘Extending the scope of the Unfair Terms discipline in consumer contracts- an economic and behavioural perspective’, *Rotterdam Institute of Law and Economics Working Paper Series*, No 2008/01, 10.

³⁴ This feature reduces transaction costs for a consumers. Unlike the case with an ordinary consumer loan, the consumer doesn’t need to apply again for the ‘new’ loan, sparing him the trouble of filling out the loan documentation again, etc. See I. RAMSAY, ‘Consumer Credit Society and Consumer Bankruptcy’, in J. NIEMI-KIESILÄINEN, I. RAMSAY and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 20.

³⁵ E. ELLINGER, E. LOMNICKA and R.J.A. HOOLEY, *Ellinger’s Modern Banking Law* (fourth edition), Oxford, Oxford university press, 2005, 689.

³⁶ In 2006, more than 98% of the registered overdraft facilities were open-end agreements. See H. DE DONCKER, ‘Kredieten aan particulieren- Analyse van de in de Centrale voor Kredieten aan Particulieren geregistreerde gegevens’, *Nationale Bank van België, Working Paper document n° 78*, January 2006, 8.

³⁷ With regard to overrunning: see article 18 Consumer Credit Directive. It’s important to notice that the fact that overdraft facilities are often included in the standard personal account packages offered by financial institutions, boost the statistics regarding this type of credit. Further we will see that competition in case of bundling from overdraft and current accounts often shifts towards aspects other than the borrowing rate e.g. interest rate for savings. See number 11 and the following.

³⁸ The brand new Law regarding Market practices and Consumer Protection from April 6, 2010 (Published in the Belgian State Gazette from April 12, 2010) includes a prohibition of similar practices.

³⁹ Article 3 (f) Consumer credit directive defines a credit intermediary as ‘*a natural or legal person who is not acting as a creditor and who, in the course of his trade, business or profession, for a fee, which may take a pecuniary form or any other agreed form of financial consideration: (i) presents or offers credit agreements to consumers; (ii) assists consumers by undertaking preparatory work in respect of credit agreements other than as referred to in (i); or (iii) concludes credit agreements with consumers on behalf of the creditor*’.



imagine strong commercial incentives to offer financial ‘services’ directly at the point of sale. The number of overdraft facilities granted by the latter outranks those granted by financial institutions in Belgium, as does - perhaps unsurprisingly - their default rate.⁴⁰

4. Notwithstanding the fact that non-financial institution facilities on average involve smaller amounts their counterparts granted by financial institutions, default rates are indeed significantly higher.⁴¹ Instalment credit⁴² is increasingly ‘disguised’ as an overdraft facility, enabling a borrower – that initially (just) requested finance for the purchase of a particular good or service - to make additional purchases or even to take cash withdrawals.⁴³ However this issue exceeds the scope of our present contribution, it should be noticed that Courts may (re-) characterize similar agreements as instalment credit.⁴⁴

5. **OVERDRAFT FACILITIES AND CREDIT CARDS. TWO FOR THE PRICE OF ONE?** Overdraft facilities are often linked to a(n instalment) credit card, a connection in many cases physically noticeable at the card design, containing both the issuing bank’s (or – in case of private label cards - issuing retailer’s) and the credit card company’s logo.⁴⁵ The issuing bank (or retailer⁴⁶) figures as creditor, free to determine the terms of the overdraft facility. Credit cards allow their users both to *transact* and to *finance*, and often provide their holders a number of benefits.⁴⁷ While combined in the same card, both features constitute totally distinct functions.⁴⁸ Whereas the transaction function⁴⁹ allows a card holder to make payments exceptionally easy just by presentation of the -widely accepted⁵⁰- piece of plastic in combination with a signature or PIN, the finance function distinguishes the credit card from mere debtor charge cards where funds are immediately deducted from the card holder’s personal account.⁵¹ The credit card by contrast, grants the card holder in any case an – inflation free - float period (up to thirty-days) for repayment *without being charged interest*⁵².

⁴⁰ (Non-) financial credit intermediaries are often accused to lack sufficient professional qualification to inform and advise clients about the credits offered. In 2009 almost 1.4 million facilities were registered with financial institutions against almost 2.5 million such contracts with non-financial institutions. See the 2009 Statistics from Central Individual Credit Register, page 27. See also BIS, ‘A Better Deal for Consumers. Review of the Regulation of Credit and Store Cards: Government Response to Consultation.’, March 2010, 30.

⁴¹ H. DE DONCKER, ‘Kredieten aan particulieren- Analyse van de in de Centrale voor Kredieten aan Particulieren geregistreerde gegevens’, Nationale Bank van België, Working Paper document n° 78, January 2006, 16.

⁴² The Belgian Consumer Credit Code describes payment by instalments (‘la vente à tempérament’) as ‘*tout contrat de crédit, quelle que soit sa qualification ou sa forme, qui doit normalement emporter acquisition de biens meubles corporels ou prestation de services, vendus par le prêteur ou l’intermédiaire de crédit, dont le prix s’acquitte, par versements périodiques, en trois paiements au moins, en ce non compris l’acompte*’ or ‘*every credit agreement, irrespective of its form, that in normal course of events leads to the acquisition of tangible goods or services, sold by the lender or credit intermediary, of which the price is paid by at least three payments or direct debits, besides the advance*’.

⁴³ See H. VAN DEN HAUTE, ‘Ouvertures de crédit’, in E. TERRY, *Handboek Consumentenkrediet*, Brugge, die Keure, 2007, 372. RAMSAY rightly ascertains that credit cards loosen consumers’ discipline compared with instalment credit since a borrower is no longer bound to fulfil regular payments. I. RAMSAY, ‘Consumer Credit Society and Consumer Bankruptcy’, in J. NIEMI-KIESILÄINEN, I. RAMSAY and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 22.

⁴⁴ In this regard, the Brussels Court Appeal decided in a recent (hence unpublished) Judgement that an (alleged) overdraft facility could be characterized as a ‘classic’ loan, what paved the way to the application of the legal provisions incorporated in the Civil Code. Similar (re-) qualification might occur with regard to ‘disguised’ overdraft facilities. See Brussels Court of Appeal (ninth Chamber), September 15 2009 (unpublished).

⁴⁵ The Belgian Legislator considers credit cards as a *modality* of overdraft facilities which explains why there is no separate legislation on credit cards. See E. VAN DEN HAUTE, ‘Ouvertures de crédit’, in E. TERRY, *Handboek Consumentenkrediet*, Brugge, die Keure, 2007, 371.

⁴⁶ ‘Co-branding’ implies an agreement between a credit card issuer and a business, by which a consumer can ‘earn’ benefits (e.g. points, air miles,...) when using the concerned card.

⁴⁷ Among other things credit cards offer their holders for example : discounts, loyalty programs, purchase insurances (e.g. protection against internet fraud or damaged goods), travel insurance, etc. Some cards allow their users for example to earn points for every EUR they spend with it in the issuer’s shop, points that enable them to purchase goods and/or services.

⁴⁸ O. BAR-GILL, ‘Seduction by Plastic’, 98 *Nw. U. L. REV.*, 1373.

⁴⁹ Credit cards originated from this transaction function. In the U.S., they proved to be a solution for reluctance to accept non-local checks. See R.J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006.

⁵⁰ For example in Belgium, Visa and Mastercards are accepted by more than 6000 retailers.

⁵¹ Debit cards immediately debit the payment from the card holder’s account. If there are insufficient funds on this account, payments (or cash withdrawals) could either be refused, or not, which leads to a (un)authorized overdraft.

⁵² The costs for this (float-period) service are borne by the retailers who’s account is credited with the amount of the good or service acquired by the card holder minus a merchant discount fee. See A. J. LEVITIN, ‘Priceless? The Social costs of credit card merchant restraints’, *Public Law & Legal Theory Working Paper Series*, Research Paper No. 973974, January 2008, available at www.ssrn.com



After this period, the cardholder either— depending on the nature of his contract- has to repay the amount as indicated on the monthly statement in full (in general through direct debit), or enjoys a dispersed repayment regime. The latter, implies vocation on the overdraft facility and leaves the cardholder with the choice either to repay a fixed (monthly) amount or a percentage – in general minimum 5 percent- of the balance.⁵³ Albeit consumers face the possibility of merely using their card for convenience or as a safety net⁵⁴ (transacting)⁵⁵, drawing a line between the two distinct functions often proves difficult. This coupling between both functions might therefore result in unintentional, sometimes even unconscious use of credit. Unbundling, if not legal, at least mental could provide a solution here.⁵⁶ Notwithstanding joint offers are in principle allowed, Belgian Legislation foresees a prohibition on joint offers in the financial services sector.⁵⁷ To date, bundling of transaction and credit services is however not targeted by this legal prohibition. Those who succeed in using their credit card as it were a debit card benefit serious cross-subsidizing from less disciplined or financially troubled credit card users.⁵⁸

(B) In search for the quasi-invisible⁵⁹ hand: some evidence about markets for consumer finance.

6. *INTRODUCTION.* In a (neo)classical conception⁶⁰, rational and informed consumers are both *able* and *prepared* to shop around⁶¹ and compare competing credit offers.⁶² While selling relatively homogenous products⁶³, each creditor voluntarily discloses the most attractive credit terms in an attempt to distinguish his business from competitors. The price of credit reflects the time value of money, inflation and risk of default.⁶⁴ Freedom-of contract serves as a system enhancing consumer welfare, presumptively allowing - *homo economicus* - parties to maximize wealth in a pareto-efficient way. Consumers are able to perform complex calculations allowing them to make an optimal financial planning and face constant trade-offs: consumption (dissaving) is balanced against other appropriation of income (e.g. investment on the savings account); different types of credit are subject to substitution.⁶⁵ Preferences are stable. Besides product innovation, competition results in more attractive credit terms and lower margins.

⁵³ Below we will argue that the obligation to make only minimum payments are a risky feature of overdraft facilities.

⁵⁴ This safety net is also referred to as the cards' 'private insurance function'. See I. RAMSAY, 'Consumer Credit Society and Consumer Bankruptcy', in J. NIEMI-KIESILÄINEN, I. RAMSAY and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 20-25.

⁵⁵ AUSUBEL designates those card holders as 'convenience users', see L. M. AUSUBEL, 'The Failure of Competition in the Credit Card Market', *The American Economic Review*, Vol. 81, 70. Safety, figuring on the second place of Maslow's 'hierarchy of needs', is highly important for consumers. Creditors therefore have an incentive to emphasize this feature in their advertising and brand management. This can for example – clearly - be observed in financial publicity which often refers to safety.

⁵⁶ See in this context: O. BAR-GILL, 'Bundling and Consumer Misperception', *Chi. L. Rev.*, Vol.73, 33.

⁵⁷ Article 72 of the (old) Act on Market Practices and Consumer Protection.

⁵⁸ Mere transactors therefore earn *de facto* interest on their payments made by credit card. See V. STANGO and J. ZINMAN, '[What Do Consumers Really Pay on Their Checking and Credit Card Accounts? Explicit, Implicit, and Avoidable Costs](#)', *American Economic Review*, vol. 99(2), 434. In *Office of Fair Trading (Respondents) v . Abbey National plc & Others*. Lord Phillips referred to a 'reversed Robin hood exercise'.

⁵⁹ V. GOLDBERG, 'Institutional Change and the Quasi-Invisible Hand', *J. Law Econ.* (Journal of Law and Economics), Vol. 17, No. 2, 1974, pp. 461-492

⁶⁰ See for example: G.S. BECKER, *The Economic approach to human behaviour*, The University of Chicago Press, Chicago, 1976, 14.

⁶¹ The ability to shop around and switch from creditor is deemed to prevent far-reaching creditor powers that might induce coercion. See M. FRIEDMAN, *Capitalism and Freedom*, Chicago, University of Chicago press, 1962, 15.

⁶² L. E. WILLIS, 'Decision-making & the Limits of Disclosure: The Problem of Predatory Lending' (June 2005), *Md. L. Rev.* (Maryland Law Review), Vol. 65, 741. Available at SSRN: <http://ssrn.com/abstract=748286> or doi:10.2139/ssrn.748286

⁶³ L. M. AUSUBEL, 'The Failure of Competition in the Credit Card Market', *The American Economic Review*, Vol. 81, 50.

⁶⁴ R. M. HYNES and E. A. POSNER, 'The Law and Economics of Consumer Finance', *John. M. Olin Law & Economics Working Paper No. 117* (2nd Series), February 20, 2001, available at <http://ssrn.com>.

⁶⁵ S. BLOCK-LIEB, E. J. JANGER, 'The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided 'Reform' of Bankruptcy Law', *Tex. L. Rev.* (Texas Law Review), Vol. 84, 1492.



7. Many doubt the existence of an above described market for credit. Market distortions explain why the market for consumer finance is not working well for many consumers.⁶⁶ Supra-competitive, rather inelastic⁶⁷ interest rates⁶⁸ may indicate imperfect competition.⁶⁸ Even if there were perfect competition, this might be inadequate to cure market inefficiencies. Individuals trying to conclude credit agreements in a pareto-efficient way, may be hindered to do so. Significant ‘information failures’ take place.⁶⁹ Especially search-costs are considered to be an important consumer constraint when shopping for money.⁷⁰ Part B goes more deeply on some characteristic features of *markets* for consumer credit, before we throw a light at some cognitive biases and heuristics of *agents* operating on those markets in part C.

8. **ASYMMETRIC INFORMATION.⁷¹ CREDITOR.** Interest rates might reflect the creditor’s nability to accurately assess the risk of default and/or the future use-pattern⁷² of a potential overdraft borrower (adverse selection). Rational borrowers have the informational advantage since they are best aware of their own willingness as well as ability to repay the borrowed funds.⁷³ Overdraft repayment is a function of a number of uncertain future events (e.g. job loss/making career, successful/unsuccesful marriage, evolutions in the (house) markets,..) and *moral hazard*, the ‘woolly economic term’ describing potential outcomes of shielding risk takers from the consequences of failure.⁷⁴ Personal insolvency regimes might for example (at least for some consumers) function as ‘shield’ with regard to consumer credit.⁷⁵ However questionnaires⁷⁶, security interests⁷⁷, credit scores⁷⁸ and databases containing information about the “credit track” of a debtor⁷⁹, pooling, or the fact that an overdraft facility is ‘repayable at call’ could moderate this effect, perfect loss-insurance remains a fiction.⁸⁰ The fact that most facilities are open-end agreements only enhances adverse selection risks.⁸¹

⁶⁶ OFFICE OF FAIR TRADING, ‘Personal current accounts in the UK. An OFT market study.’, 2008, 2. Available at www.fsa.com

⁶⁷ However interest rates generally came down last decades, the evolution of the spreads between credit card rates and other money market rates could be an indication of imperfect competition. See in this context for example : L. M. AUSUBEL, ‘The Failure of Competition in the Credit Card Market’, *The American Economic Review*, Vol. 81, 53; using the adjective ‘sticky’ when talking about credit card interest rates; P.S. CALEM, M. B. GORDY and J. MESTER, ‘Switching Costs and Adverse Selection in the Market for Credit Cards’, Research Department Federal Reserve Bank of Philadelphia, Working Paper No. 05-16, July 2005,6

⁶⁸ O. BAR-GILL, ‘Seduction by Plastic’, 98 *Nw. U. L. REV.*, 1373.

⁶⁹ I. RAMSAY, ‘Rationales for Intervention in the Consumer Marketplace’, Occasional Paper, Office of Fair Trading, London, 15 and following.

⁷⁰ L. E. WILLIS , ‘Decision-making & the Limits of Disclosure: The Problem of Predatory Lending’ (June 2005), *Md. L. Rev.*, Vol. 65, 742. Available at SSRN: <http://ssrn.com>

⁷¹ Asymmetric information could be described as a situation where not every agent (e.g. someone wishing to conclude a contract) is in possession of all the relevant information on a market (e.g. product characteristics). This could lead to inefficient markets. For further information on this and other economic terminology : see J. EATWELL, M. MILGATE and P. NEWMAN(eds.), *The new Palgrave : a dictionary of economics*, London, MacMillan, 1991.

⁷² Mere ‘convenience users’ (see nr. 5) are obviously less profitable for creditors than those consumers who intensively make use of the possibility to borrow on the credit card. See L. M. AUSUBEL, ‘The Failure of Competition in the Credit Card Market’, *The American Economic Review*, Vol. 81, 70-71.

⁷³ S. BLOCK-LIEB, E. J. JANGER, ‘The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided ‘Reform’ of Bankruptcy Law’, *Tex. L. Rev.* Vol. 84, 1498.

⁷⁴ A. R. SORKIN, *Too Big To Fail. The Inside Story of How Wall Street and Washington Fought to Save the Financial System- and Themselves*, New-York, Viking, 2009, 33.

⁷⁵ With regard to consumer credit (alleged) moral hazard indeed can arise from the fact that consumer credit laws as well as personal bankruptcy laws (apparently) cap borrowers’ downside risks linked to excessive borrowing whereas they for example ceil charges payable for default, etc. Overdraft facilities risk to be subject of an enhanced moral hazard risk (among other things) given their open-end character that hampers creditors’ supervision: flexible repayment schemes obviously complicate lenders’ monitoring of a debtor’s financial situation. See I. RAMSAY, ‘Consumer Credit Society and Consumer Bankruptcy’, in J. NIEMI-KIESILÄINEN, I. RAMSAY and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 24.

⁷⁶ While focussing on current earnings and fixed monthly expenses, such questionnaires often doesn’t ask information about potential borrowers ‘overall wealth’. An unemployed housewife that inherited millions might therefore pay an excessive risk premium due to asymmetric wealth information. See S. DEY and G. MUMY, ‘Determinants of Borrowing Limits on Credit Cards’, Bank of Canada Working Paper 2005-7, March 2005.

⁷⁷ In case the credit is granted by a financial institutions, often a pre-existing depository relationship with the borrower exists; allowing the lender an insight on a consumer’s financial behaviour.

⁷⁸ However intended to reduce the credit risk for lenders, credit scores as well as databases are sometimes accused to boost lenders profits since they are deemed to be a tool enhancing market segmentation between high and low risk borrowers.

⁷⁹ Article 9 of the Consumer Credit Directive provides a *right of access* for a foreign creditor in case of cross-border credit to ensure the Single Market for Financial services.

⁸⁰ E.g. the impossibility to recoup the cost of recovery on the borrower. See R. M. HYNES and E. A. POSNER, ‘The Law and Economics of Consumer Finance’, *John. M. Olin Law & Economics Working Paper* No. 117 (2nd Series), February 20, 2001,11. available at



9. **ASYMMETRIC INFORMATION. BORROWER.** Are you aware of your current debit rate or annual percentage rate (A.P.R.)? Or the average rate on the market? No? Don't feel lonely, little borrowers are.⁸² Naming other sectors where a majority of consumers is unaware of the price of products they purchase proves not to be easy.⁸³ Consumers lack sufficient knowledge of the credits that are offered on the market. As mentioned earlier, search-costs seem to be part of the explanation. According to classic economical theory, policy intervention is justified when information costs are excessive. Before assessing legal remedies, both pre-contractual-as contractual, to reduce information costs (e.g. the use of plain and intelligible language) further in this contribution, we explore the premise that information costs with regard to credit are considerable.

10. **CREDIT IS A COMPLEX PRODUCT.** A sufficient understanding of (the information provided by a creditor about) overdraft facilities involves substantial "search costs" for a borrower. It requires him to become familiar with some financial basics and to struggle through – often terribly boring and user-unfriendly - documentation offered by creditors.⁸⁴ Complex price structures of credit (lines), with both (fixed) fees⁸⁵ and variable interest rates⁸⁶, make it hard for consumers to get an exact idea of what a specific credit facility will cost them, given overdraft facilities' fluctuating character (see nr. 3). Even a mere A.P.R. (Annual Percentage Rate) calculation often seems to trouble borrowers.⁸⁷ The value of A.P.R. as primal yardstick for calculating the cost of credit increasingly devaluated given creditors' practice to unbundle credit costs by excluding several charges from the A.P.R. calculation.⁸⁸ Moreover, once a consumer concluded an agreement that allows him to overdraw his account, the costs that such overdraft brings along are less perceptible than other prices daily paid by consumers. Since it is common that (interest) charges are automatically deduced from a borrower's account x-days after receipt of a monthly statement, consumers are less confronted with them.⁸⁹ Monthly statements prove to be a poor factor to alter this "stealth" character of bank

<http://ssrn.com>. Moreover creditors often suffer from the prisoners' dilemma when recovering debt from a defaulting borrower with numerous credit commitments. See N. HULS and others, *Over indebtedness of consumers in the EC member states: facts and search for solutions*, Diegem, Kluwer éditions juridiques, 1994, 207-209.

⁸¹ Needless to say that a re-evaluation of a borrower's creditworthiness for such open-end agreements would prove a convenient means to diminish credit risks involved with this type of credit.

⁸² A UK market survey learns that for example more than 75 percent of the consumers isn't aware of the credit rate on their current account. See OFFICE OF FAIR TRADING, 'Personal current accounts in the UK. An OFT market study.', 2008, 4. Available at www.fsa.com For an older example of consumer (un)awareness: see T.A. DURKIN, 'Consumer Awareness of Credit Terms: Review and New Evidence', *Journal of Business*, Vol. 48, n° 2, 53-263.

⁸³ T. J. ZYWIKI, 'The Market for Information and Credit Card Regulation', *Banking & Financial Services Policy Report*, Vol. 28, n° 1, 14.

⁸⁴ Given the often very small font size of the information, the use of long sentences and the use of 'legalese' language often even difficult to understand for legal professionals, let alone lay people. See D. POGRUND Stark and J. M. CHOPLIN, 'A License To Deceive: Enforcing Contractual Myths Despite Psychological Realities', *Working Paper*, 18 and the following.

⁸⁵ For example fees for cash advances, credit- insurance, over-limit fees, etc. Such largely invisible fees were initially introduced to compensate dropping interest rates.

⁸⁶ Article 60 of the current Belgian Consumer Credit Code foresees an exception on the general principle laid down in article 30 of the Law prescribing that a creditor is not allowed to unilaterally change terms of the credit agreement, granting creditors the right to modify the A.P.R. when dealing with overdraft facilities. This right is accompanied with information requirements and a right for the borrower to end the agreement. Since most overdraft facilities are open-end agreements such principal exception, can be judged as reasonable.

⁸⁷ STANGO and ZINMAN provide a simplistic example. A creditor offers a consumer that wishes to loan \$1000 by making twelve monthly instalments two options: the first requires the borrower to pay an A.P.R. from 25 percent, the second requires monthly payments of 100 Dollar. Many consumers will opt for the latter offer, however it has an A.P.R. of 35 percent whereas the A.P.R. of the first offer only amounts to 25 percent. See V. STANGO and J. ZINMAN, 'How a Cognitive Bias Shapes Competition: Evidence from Consumer Credit Markets', September 5, 2006), 9. Available at SSRN: <http://ssrn.com/abstract=928956>

⁸⁸ For credit agreements within its scope, the Consumer Credit Directive aims to prevent such unbundling of prices in order to enhance competition in the markets for consumer finance. Article 19 prescribes how the annual percentage rate has to be calculated, stipulating for example that '*The costs of maintaining an account recording both payment transactions and drawdowns, the costs of using a means of payment for both payment transactions and drawdowns, and other costs relating to payment transactions shall be included in the total cost of credit to the consumer unless the opening of the account is optional and the costs of the account have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer.*' Regarding overdraft facilities linked to a current account one must not only focus on the **direct price**, this is what a consumer must to pay for using the overdraft facility, but also on **indirect price aspects**, e.g. the fact that a current account with overdraft facilities yields low returns (i.e. a loss of potential gains).

⁸⁹ Some consumers might therefore even be unaware of the fact that they have been charged by the financial institution. See OFFICE OF FAIR TRADING, 'Personal current accounts in the UK. An OFT market study.', 2008, 72. Available at www.fsa.com



charges. Given the fact that shopping for money, an intangible product, unlike other consumer contracts for most consumers doesn't occur often, benefits from *personal* learning appear to be limited.⁹⁰

Moreover, *interpersonal* learning has a more modest role than in other sectors for at least two reasons : firstly, people tend to be discrete about their financial affairs. Whereas people will for example easily discuss the purchase of a new car, this will be less the case when shopping for credit. "Money" and all the more (personal details about) financial products aimed at providing funds when own resources are scarce, seem to belong to our more private sphere, what explains a first barrier for interpersonal learning.⁹¹ Secondly, even if people overcome this diffidence, it proves not easy to learn from others. Credit is a non standardized product (given the almost countless number of credit formulas). The odds are that my neighbour and I have completely different contracts, what results in the impossibility to compare and learn from each other. Complexity also plays a significant role at both the legislative and supervisory level.⁹² A look on Belgium's current credit legislation raises suspicions that policymakers are also struck with complexity when designing legislation.

11. CONSUMERS DON'T SHOP AROUND, NOR READ THE FINE PRINT: "ADVERSE SELECTION ON ITS HEAD"⁹³. How much credit offers did you collect before purchasing your latest credit (card)? Chances are there that you can count them on one hand, but again you are not alone. A vast majority of borrowers doesn't shop around.⁹⁴ This is all the more the case when overdraft facilities are linked to a current account or when credit is offered by non-financial institutions that literally throw credit to consumers' head in order to induce them to purchase goods and/or services.⁹⁵ In the latter case, consumers could be expected to devote efforts especially to comparison shopping for desired goods or services, and this to the detriment of shopping for finance.⁹⁶

If already a vast majority of the consumers fails to shop around, even a far greater majority fails to *read* the credit terms. Informed consumers are deemed to be the driver of market discipline.⁹⁷ Knowledge about essential product elements, prices and seller's legal obligations forces creditors to offer consumers the best commercial deals, enabling him to stay in business. Little such market discipline seems to exist in markets for consumer finance. As complexity increases the cost of shopping around, rational borrowers will shop less, among other things to prevent cognitive overload⁹⁸, and the irrational ones will ignore

⁹⁰ Some scholars challenge this thesis and believe consumers do learn from their own behavioural flaws after having experienced them. A so-called 'second order rational choice model' is defended. See for example T. BROWN and L. PLACHE, 'Paying with Plastic: Maybe Not So Crazy', *Chi. L. Rev.*, Vol. 73, 86.; ⁹⁰ S. ARGARWAL, S. CHOMSISENGPHET, C. LIU and N. S. SOULELES, 'Do Consumers Choose the Right Credit Contracts?', *Federal Reserve Bank of Chicago Working Paper Series*, WP 2006-11, October 2006, 16.; ARGAWAL, DRISCOLL, GABAIX and LAIBSON ascertain that learning is a powerful tool to reduce costs involved with credit cards, but that knowledge is subject to depreciation. See S. ARGAWAL, J.C. DRISCOLL, X. GABAIX and D. LAIBSON, 'Learning in the Credit Card Market', NBER Working Paper No. 13822, February 2008, 3-17. R. A. Epstein, 'Second Order Rationality: What Both Rational Choice Theory and Behavioral Economics Overlook'.

⁹¹ Unsurprisingly, a credit's discrete character often equally figures as selling point in publicity.

⁹² Not that we claim that consumer credits' complexity even comes near to the financial alchemy of other financial products such as for example CDO's (Credit default obligations) etc. Nonetheless it is obvious that a thorough revision for example of an overdraft publicity requires an investment of time, staff, etc. e.g. to recalculate simulations and A.P.R. examples.

⁹³ L. E. WILLIS, 'Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending' (June 2005), *Md. L. Rev.*, Vol. 65, 751.

⁹⁴ A recent study in the Netherlands indicated that a **majority** of the borrowers failed to compare an accepted credit offer with other credit offers. See EIM, *Overkreditering aan banden: onderzoek naar de effectiviteit van beleid om overkreditering tegen te gaan*, Zoetermeer, 2007.

⁹⁵ A UK survey learns that half of the store card borrowers made their decision to apply for such store card whilst talking to a staff member. See BIS, 'A Better Deal for Consumers. Review of the Regulation of Credit and Store Cards: Government Response to Consultation.', March 2010, 30. The fact that a consumer, while shopping could be 'taken by surprise' to sign up for credit, was one of the rationales provoking the enactment of a right of withdrawal in article 14 of the Consumer Credit Directive. On the right of withdrawal, see E. TERRY, *Bedenktijden in het consumentenrecht : het herroepingsrecht als instrument van consumentenbescherming*, Antwerpen, Intersentia, 2008.

⁹⁶ W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.*, (Wisconsin Law Review) 1973, 418.

⁹⁷ If consumers shop around, a business will try to offer better credit terms than his competitors. This could result in product innovation and cheaper credit.

⁹⁸ See R. K. RATNER, D. SOMAN, G. ZAUBEMAN, D. ARIELY, and others, 'How behavioral decision research can enhance consumer welfare: From freedom of choice to paternalistic intervention', *Markett Lett.*, 2008, 387. The choice not to shop around could also be



complexity while proceeding.⁹⁹ A lot of consumers lack the financial basics that enable them to compare different credit formulas on the market in order to be a servant of market discipline. Informational market power explains why creditors seem to enjoy a free ticket to target weak consumers by offering them credit on onerous terms, since a large group of borrowers fails to shop around proactively and is therefore unaware of the onerous character of the terms.¹⁰⁰ Lenders, consequently making a lot of money with price premiums, obviously have little incentive to offer better credit terms to (uninformed) consumers.¹⁰¹

12. Credit is often purchased at a financial institution with whom the consumer already has a relation.¹⁰² Current accounts figure as gateways for the cross-sale of other financial products.¹⁰³ Reputation, the fact that family members are already client and creditor's location are other major factors determining consumers choice¹⁰⁴ and figure as entry-barriers for new creditors that wish to enter the market for consumer finance.¹⁰⁵ Some (indebted) consumers (presume to) have besides little other choice than accepting onerous terms, in order to be eligible for credit or to be able to purchase products or services offered by a non-financial creditor. Financially troubled consumers are likely to focus on eligibility for credit. It is plausible that in those cases credit terms are of minor importance. Shopping around involves - besides the usual search costs¹⁰⁶ - sometimes also financial costs for a consumer. Some creditors require borrowers indeed to pay an application fee (e.g. charges for the consultation of a (public) database).¹⁰⁷ Such payments or *sunk costs*¹⁰⁸ may incite debtors to renounce further shopping and to contract with the creditor to which they paid an application fee, preventing- among other things- to incur pecuniary loss, even when the credit offered is rationally not the best choice and price differences are limited ('throwing good money after bad money').¹⁰⁹

13. **FINANCIAL CONSERVATISM.** In addition to a lack of *proactive* shopping, even less consumers shop around in course of an existing credit relation. Once contracted, many borrowers remain loyal towards both their original creditor as credit agreement. Switching rates are correlated with market health. If consumer mobility is low, as is the case in markets for consumer finance, this might be an indication of disturbed markets. Some literature suggests that

explained based on a 'time-saving assumption' of some (rational?) consumers that most credit terms are all in all the same. See ROSENBERG, A. S., 'Regulation of Unfair Bank Fees in the United States and the European Union: Current Trends and a Proposal for Reform', *TJSL Legal Studies Research Paper No. 1028163*, November 2007, 18.

⁹⁹ O. BAR-GILL, 'The Law, Economics and Psychology of Subprime Mortgage Contracts', *Cornell L. Rev.* (Cornell Law Review), Vol. 94.

¹⁰⁰ I. RAMSAY, *Rationales for Intervention in the Consumer Marketplace*, Occasional Paper, Office of Fair Trading, London, 25 and following. Examples of how financial unawareness can lead to perverse effects are thick on the ground in the Belgium Jurisprudence. A recent case involved for example, a situation where an insurance against job loss was sold to an *unemployed* borrower.

¹⁰¹ I. RAMSAY, *Rationales for Intervention in the Consumer Marketplace*, Occasional Paper, Office of Fair Trading, London, 25 and following.

¹⁰² See D. CRUICKSHANK, 'Competition in UK Banking, a Report to the Chancellor of the Exchequer', March 2000 (Cruickshank report), paragraph 4.64.

¹⁰³ See DG HEALTH AND CONSUMER PROTECTION, 'Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection. Final Report', November 2009, 31.

¹⁰⁴ The OFT market survey revealed that those factors are far more decisive factors than for example competitive interest rates. See OFFICE OF FAIR TRADING, 'Personal current accounts in the UK. An OFT market study.', 2008, 58. Available at www.fsa.com

¹⁰⁵ In this context, a reference to the Reader's Digest European Trusted Brands Study proves relevant. Besides conservative, the study reveals that Belgian consumers in general seem to put their trust in well-known brands. See also 'Belg is opvallend merkentrouw', *De Standaard*, Thursday April 8 2010.

¹⁰⁶ The introduction of the internet reduced shopping costs for consumers (e.g., reduction of search time, transportation costs,...). Both creditors websites as websites that enable consumers to compare different credit offers are deemed to make it easier for consumers to shop around. For an U.S. example: see www.Cardhub.com. The capacity of the internet as a shopping enhancing tool should however be doubted. See O. BAR-GILL, 'The Law, Economics and Psychology of Subprime Mortgage Contracts', *Cornell L. Rev.*, Vol. 94.

¹⁰⁷ Such practice is however more common in the U.S. than in European countries. It is important to notice that the European Consumer Credit Directive restricts such practices for credit agreements within its scope. See article 14 CCD with regard to the right of withdrawal (article 18 in the new Code).

¹⁰⁸ Sunk costs can be briefly described here as costs that a person has to make that can't be recovered afterwards.

¹⁰⁹ L. E. WILLIS, 'Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending' (June 2005), *Md. L. Rev.*, Vol. 65, page 22 working paper. Available at SSRN: <http://ssrn.com/abstract=748286> or doi:10.2139/ssrn.748286



substitution to other financial products even remains limited when interest rates are subject to changes.¹¹⁰ Such findings contradict with classic theory arguing that changes of interest rates induces consumers to dissave or to shop around. Instead of rewarding loyalty, financial institutions are sometimes accused to exploit consumer conservatism. In the insurance sector, for example, it is common practice to price discriminate by raising premia of existing contracts to subsidize teaser premia offered to new policy holders (existing policy holders suffer i.e. a price raise in order to compensate teaser premia offered to new clients from the insurance companies).¹¹¹

As already for important market segments the cost of credit is not a key factor to determine their choice of creditor, this is all the more the case for price increases along the way.¹¹² Existing financial consumers might find themselves in a situation where the cross-subsidize both defaulting borrowers and new client teaser-rates.¹¹³

14. Besides search-costs¹¹⁴, *loss-aversion*¹¹⁵ and *believe perseverance*¹¹⁶ may be major factors explaining low switching grades.¹¹⁷ Negative experiences with one's financial institution (or 'push factors') tend to be of far greater importance for explaining switching in the market for consumer finance than "pull-factors" or positive incentives to change from institution or credit contract (e.g. a lower interest rate after refinancing).¹¹⁸ Publicity targeting especially new players on the market (youngsters, novices on the labour market, couples that open a joint-account or build a house,...) instead of focussing on switchers are an indication of this predominant conservative trend.¹¹⁹ Overdraft facilities, usually open-end agreements (see number 3) lack a natural break contrary to for example close-end loans or insurance contracts that have to be renewed from time to time.¹²⁰ Cross-selling and "product tying strategies"¹²¹, might exacerbate this conservative trend.¹²² Above we already raised concerns about the tie between current accounts and overdraft facilities in this context. An appeal on an already existing overdraft facility saves financially troubled consumers the daunting task (among other things the risk of embarrassment upon refusal) of applying for new credit at an

¹¹⁰ See for example J. WRIGHT, 'Behavioral Law and Economics, Paternalism, and Consumer Contracts: an Empirical Perspective', *NYU Journal of Law & Liberty*, Vol. 2, 483.

¹¹¹ D. DE MEZA, B. IRLENBUSCH and D. RYNIERS, 'Financial Capability: A Behavioural Economics Perspective', a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 33.

¹¹² L. E. WILLIS, 'Decision-making & the Limits of Disclosure: The Problem of Predatory Lending' (June 2005), *Md. L. Rev.*, Vol. 65, 751.

¹¹³ In such scenario's, creditworthy borrowers might indeed end up paying a (part of the) risk-premium of new, less-creditworthy borrowers, enjoying teaser-rates.

¹¹⁴ CALEM, GORDY and MESTER conclude that despite recent evolutions in the credit card market important barriers to switch remain See P.S. CALEM, M. B. GORDY and J. MESTER, 'Switching Costs and Adverse Selection in the Market for Credit Cards', Research Department Federal Reserve Bank of Philadelphia, Working Paper No. 05-16, July 2005,6 ; For an overview of search-costs faced by a consumer when (considering) switching see: L. M. AUSUBEL, 'The Failure of Competition in the Credit Card Market', *The American Economic Review*, Vol. 81, 69.

¹¹⁵ Loss-aversion relates to (presumed) switching costs a borrower would have to pay to switch account. A borrower might fear both direct as indirect financial costs when considering a transfer. The Consumer Credit Directive introduces a 'cap' on the cost a borrower might be required to pay in case of early repayment. Loss of benefits of loyalty programs offered by creditors is however not envisaged by the directive. Indirect costs could however significantly raise the direct costs. An example. Financial relationships are characterised by faith. Rebuilding a trustful relationship (creating goodwill) is therefore an investment for a borrower seeking to switch from financial institution. An inferior trust relation might be translated in higher credit costs.

¹¹⁶ Consumers tend to be sceptical about contradicting opinions once they formed an original opinion. Evidence undermining original views will suffer under scepticism. See D. de Meza, B. IRLENBUSCH and D. RYNIERS, 'Financial Capability: A Behavioral Economics Perspective', a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>.

¹¹⁷ Article 16 of the consumer credit directive stipulates a cap on how much a consumer might have to pay in case of early repayment.

¹¹⁸ OFFICE OF FAIR TRADING, 'Personal current accounts in the UK. An OFT market study.', 2008, 47. Available at www.fsa.com

¹¹⁹ So-called 'event based life cycle management' strategies implicate financial marketing of 'tailored' products to the right borrowers, at the appropriate moment. See DG HEALTH AND CONSUMER PROTECTION, 'Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection. Final Report', November 2009, 35.

¹²⁰ OFFICE OF FAIR TRADING, 'Personal current accounts in the UK. An OFT market study.', 2008, 89. Available at www.fsa.com

¹²¹ This is the sale of a financial product conditional on the purchase of other financial products offered by the financial institution (e.g. borrowers that are required to take an insurance issued by the lender or an allied company) . See DG HEALTH AND CONSUMER PROTECTION, 'Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection. Final Report', November 2009, 31.

¹²² A. J. LEVITIN, 'Priceless? The Social costs of credit card merchant restraints', *Public Law & Legal Theory Working Paper Series*, Research Paper No. 973974, January 2008, available at www.ssrn.com 31 and 52.



unfamiliar institution.¹²³ Lacking price transparency¹²⁴ and *perceived* (administrative) costs involving a switch, feed consumers' fearfulness.¹²⁵ Even if borrowers would be willing to alter their credit formula or to withdraw from the contract when interest rates are going up, such transfer not always proves easy (especially for borrowers in financial distress) since borrowers will have to repay the full credit balance before switching. A borrower might face himself in a kind of 'catch 22 situation': or he decides not to switch from creditor and keeps paying high interest rates, or he does withdraw from the contract in order to find cheaper credit which requires a repayment of the full balance at once.

15. CREDITORS DON'T REDUCE THE "SEARCH COSTS" NOR OFFER THE MOST ATTRACTIVE TERMS. Information is a public good. Free-rider behaviour, both from consumers and competitors is a dissuading factor for borrowers education by lenders.¹²⁶ If moreover the assumption that borrowers fail to shop around is correct, and if consumers are indeed imperfectly informed about the complex financial product that credit is, creditors have little incentive to offer more transparent or attractive terms since there would be little gain in such strategy. For example: what could incite a creditor to offer overdraft facilities with lower charges for unauthorized overdrafts if evidence shows that consumers (on the demand side) fail to notice those new – more attractive- terms? A reduced profitability per account would fail after all to attract more borrowers. Malicious minds even reveal a self fulfilling prophecy here: a consumer's failure to shop around, resulting in – passive - lenders free to maintain onerous terms, consequently taking borrower's incentives away to shop since such shopping won't benefit his situation,...

16. THE MARKET FOR CREDIT IS CONTINUOUSLY AND FAST CHANGING. Unlike other industries, a creditor is able to change the financial products he offers immediately and at low cost: creating new credit formulas will take him little time. By printing a form, a new financial product is born.¹²⁷ This continuously and fast changing character of markets for (consumer) finance¹²⁸ significantly raises search-costs (for consumers).¹²⁹ If a borrower wants to remain informed, he has to study the new terms what requires an additional investment from him.¹³⁰ However creditors often introduce new credit terms and products, such innovations rarely prove beneficial for borrowers. Even if consumers would notice that a creditor offers more attractive terms or for example uses of plain and intelligible language (in order to reduce consumer's search costs), chances are small that such – consumer friendly - innovation would result in a perpetual commercial success for the creditor who initially launched the innovation. This given the above discussed financial conservatism and since competitors are able to copy the new financial product in no time. The initiator would therefore fail to mount he's market share by the renewed credit offer.¹³¹ Financial incapable consumers, omitting to

¹²³ W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.*, 1973, 423.

¹²⁴ See S. M. Franken, 'The Political Economy of the EC Consumer Credit Directive'; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy: comparative and international perspectives*, Oxford, Hart, 2009, 132.

¹²⁵ Consumers often consider switching as an *unnatural* thing to do, possibly inflicting significant penalties. A pre-printed standard form for termination attached to the credit agreement might reduce barriers for consumers to switch. However included with regard to the right of withdrawal in both in the Time-sharing Directive as in the draft proposal of a Consumer Rights Directive, the Consumer Credit Directive doesn't foresee in such provision. See U. REIFNER, «Responsible credit in the EU-National Law, the new EU-Directive and Beyond», in E.P. DELIA (ed.), *Evolving Legislation on Consumer Credit and Trade Practices : Stimulus or Drag on Economic Activity?*, Malta, ABS Bank Publication, 2007, p. 63.

¹²⁶ I. RAMSAY, *Rationales for Intervention in the Consumer Marketplace*, Occasional Paper, Office of Fair Trading, London, 25 and following.

¹²⁷ O. BAR-GILL and E. WARREN, 'Making Credit Safer', *U. Pa. L. Rev* (University of Pennsylvania Law Review), Vol. 157, (101) 110. In their contribution the authors give the example of a famous bank which offers over 400 different credit formulas on its website.

¹²⁸ As already mentioned, product innovation can be indication of the existence of competition in the markets for consumer finance. See for example O. BAR-GILL, 'The Law, Economics and Psychology of Subprime Mortgage Contracts', *Cornell. L. Rev.*, Vol. 94.

¹²⁹ As well as supervision costs for financial authorities.

¹³⁰ O. BAR-GILL and E. WARREN, 'Making Credit Safer', *U. Pa. L. Rev.* , Vol. 157, (101)

¹³¹ See for example W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.*, 1973, 429. O. BAR-GILL and E. WARREN give a concrete example of an American bank that dropped some of its most salient credit practices. However the action was given significant attention and was applauded by the Congress, the bank reintroduced the salient practices within two years since



discipline the market, are on the other poorly armed to prevent creditors from launching new – more onerous – terms¹³² and contracts.¹³³ Although some informed consumers would resent creditors that offer such terms or contracts, such minority would not outweigh potential benefits from selling credit at imperfect informed consumers (see also nr. 11). The latter class will not drive competitors to exploit the difference in comparative advertising. The assumption that competitors would follow and introduce the same terms or contract modifications themselves seems more likely.

17. NO INFORMED MINORITY OF BORROWERS IN DRIVER'S SEAT FOR IMPROVED CREDIT TERMS. In several markets it is common practice that a small informed minority ('marginal consumers') has an influence on producers or suppliers to introduce changes, that also benefit the -less informed- majority of consumers.¹³⁴ If for example a minority of car owners publicly complains about a certain malfunctioning device, the manufacturer will be likely to change the malfunctioning device not only in complaining car owners' cars but in all the cars it has sold and ever will sell of that type. Car owners that weren't aware of the problem, and by consequence never complained about it, will nevertheless benefit from the pressure of a small informed minority.¹³⁵ This phenomenon, where an informed minority of market participants or consumer organisations advocates changes for a whole class of *free-riding* consumers¹³⁶, is less likely to happen in the field of consumer credit, among other things, because of creditors' ability to easily produce new credit products (see number 16). Because the law doesn't require creditors to offer all borrowers equal terms and contracts, the more informed consumers are unable to advocate improvements for the lesser informed majority since the creditor will be able to (price-) discriminate and to divide the market for consumer credit in different market sectors (market segmentation).

18. In Belgium, most large banks have at least one wholly owned subsidiary offering credit to less creditworthy borrowers. Some major banks also have online branches and subsidiaries promoting 'credit by text message' ("SMS-cash"). A number of them especially target the more vulnerable borrowers in their publicity. Such market segmentation has much to do with reputational constraints. Most consumers aren't aware of the fact that there is a link between the subsidiary and another larger bank. By consequence, the latter is shielded against naming and shaming (e.g. when the press or a regulator shines a light on loan sharking practices) that might undermine the so important factor 'reputation' (see nr. 12). An increased access to databases to assess creditworthiness of potential borrowers will only increase lenders' ability to price-discriminate.¹³⁷ The more informed minority is deemed to be granted more beneficial conditions than those with lesser knowledge or bargaining power.¹³⁸ The latter will not be able to free-ride on the first group's behaviour.¹³⁹

a lack of influence on its commercial results. See O. BAR-GILL and E. WARREN, 'Making Credit Safer', *U. Pa. L. Rev.*, Vol. 157, (101) 118-119.

¹³² Contracts often grant creditors the right to change the terms of existing credit relations.

¹³³ SCHILLIG refers in this context to Akerlof's 'market for lemons' and 'a race to the bottom' with regard to contract terms. See M. SCHILLIG, 'Inequality of bargaining power versus market or lemons: Legal paradigm change and the Court of Justice's jurisprudence on Directive 93/13 on unfair contract terms', *E.L. Rev.*, June 2008, 341.

¹³⁴ See R. M. HYNES and E. A. POSNER, 'The Law and Economics of Consumer Finance', *John. M. Olin Law & Economics Working Paper* No. 117 (2nd Series), February 20, 2001, 5. Available at <http://ssrn.com>.

¹³⁵ A recent example could be found in the Toyota case. In both the U.S. and Europe, the company was forced to call-back a significant amount of cars.

¹³⁶ A principal argument in such reasoning is that it is too costly for a business identify more informed consumers in order to be able to term discriminate. Given the in this contribution discussed characteristics proper to consumer credit and overdraft facilities this argument weights less with regard to the sector of consumer finance. See in this context: A. SCHWARTZ and L. WILDE, 'Intervening in Markets on the Basis of Imperfect Information: A legal and Economic Analysis', *U. Pa. L. Rev.*, Vol. 127, 630 and the following.

¹³⁷ See article 9 Consumer Credit Directive that intends an increased cross-border database access.

¹³⁸ Contra : R. KOROBIKIN, 'Bounded Rationality, Standard Form Contracts, and Unconscionability', *U. CHI. REV.*, Vol. 70., 1203.

¹³⁹ O. BAR-GILL and E. WARREN, 'Making Credit Safer', *U. Pa. L. Rev.*, Vol. 157, (101) 113.



(C) Me v myself. A behavioural approach of consumer finance.

“Restricting individual choice in a free society is as perilous as it is essential. (...) But if collective foolishness governs individual choice, then allowing an unchecked market to direct the economy can produce an undesirable allocation of resources.”¹⁴⁰

19. **THE MYTH OF THE HOMO ECONOMICUS. IMPERFECT OR BOUNDED RATIONALITY.** Consumer-errors in the decision-making process, as a consequence of rational behaviour bounded by cognitive biases (a tendency to make wrong judgments based on cognitive factors) and heuristics (time-saving strategies that simplify decision-making by substituting difficult questions by less difficult ones) might be, besides imperfect markets, another justification for legal intervention. Imperfect or bounded rationality explains, among other things, why some consumers keep overdrawing their account instead of drawing on significant saving accounts that yield poor returns¹⁴¹, why consumers omit to use other- cheaper- forms of credit (overdraft facilities could be designated as one of the most expensive forms of credit¹⁴²), why some people refrain from refinancing when interest rates are dropping¹⁴³, or why numerous borrowers seem to ‘anchor’ on monthly payments instead of A.P.R.¹⁴⁴ Moreover, preferences appear not to be stable. A large part of the consumers suffers - among other things - from impulsiveness and ‘buying moods’. Such moods might trigger the use of - easy accessible¹⁴⁵ - credit, and not at least an appeal on finance services offered by non-financial institutions. If a number of borrowers as a consequence of bounded rationality, indeed systematically¹⁴⁶ and therefore predictably under-estimates costs and risks involved with overdraft facilities, and such behaviour negatively affects the latter group¹⁴⁷, consumer policy shouldn’t disregard this psychological evidence but take it into consideration when designing consumer regulation.¹⁴⁸

Even if only a minority of borrowers chooses sub-optimal credit formulas, the

¹⁴⁰ RACHLINSKI, ‘Cognitive Errors, Individual Differences, and Paternalism’, in BROOKS-GORDON and FREEMAN (eds.), *Law and Psychology*, Oxford, Oxford University Press, 2006, 125.

¹⁴¹ Mental accounting explains why consumers often consider their finances as separated budgets (i.e. a mental barrier). See O. BAR-GILL and E. WARREN, ‘Making Credit Safer’, *U. Pa. L. Rev.*, Vol. 157, (101) 135. It should be mentioned that also a significant number of consumers borrows **too little**. A sometimes -unjustified- fear of debt can incite people to make sub-optimal financial decisions. See C.R. SUNSTEIN, ‘Boundedly Rational Borrowing’, *Chi. L. Rev.*, Vol. 73, 249.

¹⁴² In 2007, the average A.P.R. for overdraft facilities in Belgium rose up to around 16 percent. According to European Central Bank Statistics, the Average Annual Percentage Rate amounted around 9 percent. It’s therefore not difficult to ascertain a considerable spread between the base rate and the overdraft rate charged to consumers, a spread that generates considerable profits for financial institutions.

¹⁴³ A borrowing rate could either be fixed or variable. Variable borrowing rates could be linked to an index or reference rate, as well as periodically change.

¹⁴⁴ Before disclosure enactments such ‘selective-blindness’ by consumers incited creditors to ‘payments marketing’, or promoting low monthly payments while keeping silent about A.P.R. See V. STANGO and J. ZINMAN, ‘How a Cognitive Bias Shapes Competition: Evidence from Consumer Credit Markets’, September 5, 2006), 3. Available at SSRN: <http://ssrn.com/abstract=928956> A closer look at the European Consumer Credit Directive learns that article 4 of the Directive, with regard to standard information to be included in advertising, although obliging creditors to mention -among other things- the A.P.R., doesn’t give rise to any legal impediment to enlarge the (monthly) instalment amount in publicity for consumer credit.

¹⁴⁵ Easy access is least perceived by many consumers: 65 percent of the European consumers indicates to have *no difficulties* in getting access to a credit card (whereas only 57 percent of the consumers questioned thinks the same way about access to ordinary consumer credit). This picture is little different for consumers that indicate to have difficulties paying bills on time: only 55 percent of those category indicates to have *difficulties* getting a credit card. In Belgium, only 24 percent of the consumers questioned indicates that it is very or fairly difficult to get access to credit cards. See Report Eurobarometer 72.1 Poverty and Social Exclusion, February 2010, 41. Available at http://ec.europa.eu/public_opinion/archives/ebs/ebs_321_en.pdf

¹⁴⁶ However some consumers might overestimate the risk of credit, consequently using a less than optimal amount of consumer credit, the latter are a small minority. Moreover, their mistakes presumably are – in general –not as harmful (costly) than (costs arising from) underestimation of credit risks. See E. RENUART, D. E. Thompson, ‘The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise Of Truth in Lending’, *Yale J. on Reg.* (Yale Journal on Regulation), Vol. 25, 209.

¹⁴⁷ C. CAMERER, S. ISSACHAROFF, G. LOEWENSTEIN, T. O’DONOGHUE and M. RABIN, ‘Regulation for conservatives: behavioral economics and the case for ‘assymetric paternalism’’, *U. Pa. L. Rev.*, Vol. 151, 1212. Even small consumer errors might result in considerable market distortions, given the size and importance of the latter market. Bounded rationality moreover seems to be a ‘one-way street’ to the detriment to consumers. S. BLOCK-LIEB and E. J. JANGER correctly assesses that policymakers wouldn’t trouble if consumers overestimation and underestimation would occur with the same frequency. Consumers yet rarely benefit from cognitive biases.

¹⁴⁸ D. DE MEZA, B. IRLENBUSCH and D. RYNIERS, ‘Financial Capability: A Behavioral Economics Perspective’, a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 3.



aggregated implications of such mistakes couldn't be underestimated.¹⁴⁹ Regulation should encompass the protection of a *homo sapiens* kind of borrower, not rare *homo economicus*.¹⁵⁰

20. If moreover, the doubts raised by scholars about the feasibility of debiasing turn out to be correct,¹⁵¹ the prevailing information paradigm – targeting the demand side – might prove little useful: there's after all none so blind as those who won't see. Product information could be helpful if borrowers merely lack *knowledge* about overdraft facilities.¹⁵² Below we will argue that policymakers are faced with bigger challenges. If evidence demonstrates that creditors¹⁵³ systematically exploit cognitive biases, regulation's focus should shift to the supply side of the market.¹⁵⁴ The question arises whether lawmakers, besides financial consumers equally influenced by biases and heuristics when creating legislation,¹⁵⁵ should shift policy-efforts from *contract* regulation towards *product* regulation. Consequently overdraft facilities may be qualified as “harm causing debt products” and be treated analogical with dangerous products in the context of product liability law.¹⁵⁶ Before bringing up such legal reasoning, this section takes a closer look at some¹⁵⁷ of the consumer-illusions (biases) and mental-shortcuts (heuristics) concerned. It should be noted that further empirical research is – without doubt – required to apply general theory more specifically on consumer credit, to verify hypothesis deducted from other research areas, etc. One should prevent (behavioural) law and economics from becoming a new consumer policy paradigm or dogma: theories should by contrast be measured on their quality to predict borrowers' behaviour. Armed with greater predictive power, the quality of policy and legislative procedures can only improve.¹⁵⁸

21. *WISHFUL THINKING, OVER-OPTIMISM AND UNDERESTIMATION.* Consumers tend to *underestimate* financial risks involved with credit and to *overestimate* own future (financial) behaviour. Over-optimism might cause debtors not to acquire the information they need when contracting for money. If the debtor for example believes that his behaviour will never give rise to overdrafts (e.g. because a consumer firmly believes he will only use his credit card for transacting), he will have little incentive to invest time on learning which fees he might have to pay for an overdraft. Untailored disclosure might prove useless here. An uncertain overdraft fee will be accorded less weight in the decision-making process than fees or benefits (in cases where an overdraft facility is linked to a current account that generates credit

¹⁴⁹ S. ARGARWAL, S. CHOMSISENGPHET, C. LIU and N. S. SOULELES, ‘Do Consumers Choose the Right Credit Contracts?’, *Federal Reserve Bank of Chicago Working Paper Series*, WP 2006-11, October 2006, 17.

¹⁵⁰ C.R. SUNSTEIN, ‘Boundedly Rational Borrowing’, *Chi. L. Rev.*, Vol. 73, 251. This type of rational consumers are often referred to as ‘financial citizens’. See for example P. CARTWRIGHT, *Banks, consumers and regulations*, Oxford-Portland Oregon, Hart publishing.

¹⁵¹ With regard to the ability of debiasing in the field of financial decision-making little literature yet exists. Further investigation is therefore absolutely required. See on debiasing: C. J. JOLLES and C. R. SUNSTEIN, ‘Debiasing through law’, *J. Legal. Studies* (Journal of Legal Studies), Vol. 35, 199 and N. D. WEINSTEIN and W. KLEIN, ‘Resistance of personal Risk perceptions to Debiasing interventions’ in, GILOVICH, GRIFFIN, and KAHNEMAN (eds.), *Heuristics and Biases*, Cambridge Univ. Press, New York, 2002.

¹⁵² C.R. SUNSTEIN, ‘Boundedly Rational Borrowing’, *Chi. L. Rev.*, Vol. 73, 261.

¹⁵³ Assuming that creditors are more rational agents, it might prove much more efficient to target them instead of irrational consumers to correct market distortions. See I. RAMSAY, ‘Consumer Credit Society and Consumer Bankruptcy’, in J. NIEMI-KIESILÄINEN, I. RAMSAY and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 33.

¹⁵⁴ BARR-GILL ascertains that the fact that numerous businesses adapt their products and prices in response of consumer irrationality (sellers' investment), is an evidence about the robust character of some consumer biases and heuristics. See O. BAR-GILL, ‘Informing Consumers About Themselves’, *Law & Economics Research Paper Series Working Paper N° 07.-44*, 3. Given creditors' ability to change credit products immediately and at low cost (see number 16) one should however be more careful when using such reasoning with regard to credit than when talking about other sectors.

¹⁵⁵ Besides pressure from interest groups (e.g. banking organisations, consumer advocates,...) policymakers suffer not less than ordinary consumers from biases.

¹⁵⁶ A. SCHWARTZ, ‘Personal Bankruptcy Law: a Behavioural Perspective’, in NIEMI-KIESILÄINEN, RAMSAY and WHITFORD (eds.), *Consumer Bankruptcy in a Global Perspective*, London, Hart, 2004, 69.

¹⁵⁷ As it proves difficult to ascertain the exact influence of each bias and heuristics, readers must try see them all together in the larger picture of factors influencing consumers to make (irrational) lending decisions.

¹⁵⁸ Behavioural Law and economics is often criticised for lacking empirical materials that support its findings. See for example: T. BROWN and L. PLACHE, ‘Paying with Plastic: Maybe Not So Crazy’, *Chi. L. Rev.*, Vol. 73, 66.



interests) with a certain character.¹⁵⁹ The possibility offered by retailers for a spread repayment of the price of a good or service, without charges, e.g. over three months is very relevant example here. Consumers indeed risk to be unable to keep pace with the spread repayment and could glide into (unauthorized) overdraft facilities, allowing them to take up even more credit than the value of the originally purchased good or service. Over-optimism often goes hand in hand with both the *availability heuristic* and an “*illusion of control*”. The first suggests that people tend to assess the likelihood of an uncertain future event based on the degree of availability of such an event in their mind caused by own experiences or experiences of relatives – friends, media coverage,...¹⁶⁰ The latter causes consumers to overestimate their ability to avoid harmful events - capable of pushing them over the financial edge - by controlling their own behaviour.¹⁶¹ A student contracting for credit, might for example underestimate the risk of over-indebtedness since he ’s not familiar with such event (it is not “available” in his memory - availability heuristic) and might on the other hand overestimate his own contribution to obtaining an academic degree to the prejudice of other – uncontrollable - events along the way that may lead to academic failure such as severe illness, pregnancy, economic depression, ...(illusion of control). Unrealistically rosy views, along with both the *availability heuristic* and an “*illusion of control*” might colour a borrower’s perception about his ability to refund borrowed funds.¹⁶² One could assume that the EC’s “confident consumer paradigm” refers to a different kind of confidence.¹⁶³

22. Given the fact that reality often proves not to match with erroneous/ naïve borrowers’ conceptions, in many cases some of the most dangerous terms of the credit agreement become only relevant for the debtor after the occurrence of an at the time of demand for credit unexpected event, e.g. default, unauthorized overdraft,...¹⁶⁴ Card borrowers significantly seem to underestimate the funds they have already borrowed in the course of a given period. Problems of recollecting past transactions is obviously a dangerous aspect with regard to overdraft facilities. Research reveals that a consumer’s failure to check his balance, is a significant factor for unauthorized overdrafts.¹⁶⁵ Again, lenders have little incentive to draw borrowers attention on the consequences of such behaviour since it generates vast profits.¹⁶⁶ Over-optimism might be enhanced by external factors.¹⁶⁷ SOMAN and CHEEMA argued that a credit limit (awarded by a creditor) – as an indication of the creditor’s opinion about the creditworthiness of a particular consumer - can have an enhancing effect on the volume of

¹⁵⁹ A. S. ROSENBERG, ‘Regulation of Unfair Bank Fees in the United States and the European Union: Current Trends and a Proposal for Reform’, *TJSL Legal Studies Research Paper No. 1028163*, November 2007, 10.

¹⁶⁰ Extensive attention in the media for overdraft fees, over-indebtedness etc. might have to compete with creditors’ omnipresent advertising affecting positive/negative availability. See I. RAMSAY, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets*, Oxford- Portland (Oregon), Hart Publishing, 2007, 74.

¹⁶¹ KILBORN, ‘Behavioral Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions’, *Bankruptcy Developments Journal*, Vol. 22, p. 13, 2005.

¹⁶² It also seems save to presume that the extensive media coverage with regard to credit cards, over indebtedness, usury, etc. is less available for the more vulnerable consumers in our society than for those who read quality papers on a daily basis.

¹⁶³ European Institutions often refer to the confident consumer when calling for harmonisation. See for example Communication from the Commission, ‘EU Consumer Policy Strategy 2007-2013. Empowering Consumers, Enhancing Their Welfare, Effectively Protecting Them’, COM (2007) 99 final, or for example C. MCCREEVY, ‘What is the EU doing in the arena of consumer protection for financial services’, Speech at the Financial Services Ombudsman Conference, Dublin 26 June 2009. See also T. WILHELMSSON, ‘Abuse of the Confident Consumer’, *Journal of Consumer Policy*, 2004, 317.

¹⁶⁴ A. S. ROSENBERG, ‘Regulation of Unfair Bank Fees in the United States and the European Union: Current Trends and a Proposal for Reform’, *TJSL Legal Studies Research Paper No. 1028163*, November 2007, 28

¹⁶⁵ In the U.K. a market survey revealed that consumer’s failure to check their accounts is the second most important reason why consumers overdraw their account. See for example OFFICE OF FAIR TRADING, ‘Personal current accounts in the UK. An OFT market study.’, 2008, 70. Available at www.fsa.com The same bias occurs in the ITC-sector where consumers can subscribe for a formula allowing them to call e.g. 20 hours a month, to download x- MB per month for a fixed fee. Often, consumers have to pay for everything that exceeds this limit. A consumers’ failure to keep track with their users-behaviour often results in the occurrence of surcharging. Again, internet or other providers have little incentive to draw consumers on this ‘overrunning’, while advanced technologies easily allow such disclosure (e.g. by mail, by text message).

¹⁶⁶ Such profits could however be tempered by usury regulation, capping the maximum interest rate a creditor is allowed to charge.

¹⁶⁷ Over-optimism could be enhanced by external factors both on a macro- (e.g. economic forecasts) as on a micro-level (for example ‘keeping up with the joneses’)



funds borrowed by this consumer.¹⁶⁸ Some borrowers tend to believe that if a (rational-minded) financial institution or business is willing to grant them an overdraft facility, such faith cannot be but justified.¹⁶⁹

23. **HYPERBOLIC DISCOUNTING, PROCRASTINATION OR MYOPIA.** Behavioural economics explains why debtors often “fall prey to the powerful siren song of present benefits while all but ignoring future costs”.¹⁷⁰ ‘Hyperbolic discounting’, ‘myopia’ or ‘procrastination’ leads people to postpone costs, even if such cost may generate high future benefits.¹⁷¹ Myopia contradicts stable preference theories. Short-term thinking (even if this doesn’t promote current welfare) could undermine future well-being over time.¹⁷² Borrowers seem for example systematically to undervalue delayed costs and tend to weigh more importance on what is charged immediately (e.g. paying cash, the cost of acquiring a credit card) than future certain (e.g. interest rates) or uncertain charges (e.g. unauthorized overdraft fees).¹⁷³

24. A borrower’s willingness to contract for credit therefore also strongly depends on how terms are framed.¹⁷⁴ Myopia may incite a creditor to exploit complexity (for example by advertising a loan with A.P.R. 0% *for the first twelve months*, after which..).¹⁷⁵ Short-term affordability is said to be an important factor for the consumer’s decision to borrow.¹⁷⁶ BROWN and PLACHE refer in this context to consumers “lured by the short-term aspects of borrowing”.¹⁷⁷ Competition (advertising) might, besides towards new players (see number 13), therefore also be shifted from long-term price elements to those on the short-term as well as increasingly stressing short term benefits (e.g. retailers offering loyalty points when paying with *their* credit card¹⁷⁸).¹⁷⁹

25. Overdraft advertising indeed often emphasizes short term price elements, for example the possibility to make only minimum payments. Underestimation tends to reinforce this bias. Hyperbolic discounting - that by the way seems correlated with IQ¹⁸⁰, income and wealth¹⁸¹ -

¹⁶⁸See A. CHEEMA and D. SOMAN, ‘The Effect of Credit on Spending Decisions: The Role of the Credit Limit and Credibility’, *MARKETING SCIENCE*, Vol. 21, No. 1, pp. 32-53. Critics argue that SOMAN and CHEEMA’S model fails to take consumer unawareness into account. Consumer unawareness and ignorance will also be an important factor here. Consequently, many consumers won’t be aware of their own credit limit. See A. J. LEVITIN, ‘Priceless? The Social costs of credit card merchant restraints’, *Public Law & Legal Theory Working Paper Series*, Research Paper No. 973974, January 2008, 47, available at www.ssrn.com. Obviously, greater credit limits can lead to rising debt. See for example: D. B. GROSS and N. S. SOULELES, ‘Do liquidity constraints and interest rates matter for consumer behavior? Evidence from credit card data’, *QUARTERLY JOURNAL OF ECONOMICS*, 181.

¹⁶⁹ See R. J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006, 49.

¹⁷⁰ KILBORN, ‘Behavioral Economics, Over indebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions’, *Bankruptcy Developments Journal*, Vol. 22, p. 13, 2005.

¹⁷¹ D. DE MEZA, B. IRLENBUSCH and D. RYNIERS, ‘Financial Capability: A Behavioral Economics Perspective’, a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 3.

¹⁷² C.R. SUNSTEIN, ‘Boundedly Rational Borrowing’, *Chi. L. Rev.*, Vol. 73, 252.

¹⁷³ ROSENBERG, A. S., ‘Regulation of Unfair Bank Fees in the United States and the European Union: Current Trends and a Proposal for Reform’, *TJSL Legal Studies Research Paper No. 1028163*, November 2007, 10.

¹⁷⁴ V. STANGO and J. ZINMAN, ‘How a Cognitive Bias Shapes Competition: Evidence from Consumer Credit Markets’, Working Paper September 5, 2006), 10. Available at SSRN: <http://ssrn.com/abstract=928956>

¹⁷⁵ O. BAR-GILL, ‘The Law, Economics and Psychology of Subprime Mortgage Contracts’, *Cornell. L. Rev.*, Vol. 94.(page 40 working paper) See also G. LOEWENSTEIN and T. O’DONOGHUE, ‘We can do this the easy way or the hard way: Negative Emotions, Self-Regulation and the Law’, *U. Chi. L. Rev.* Vol. 73. The authors explain how separation in time of a purchase and its payment reduces the ‘pain of paying’ and therefore could incite less than perfect rational consumers to spent more.

¹⁷⁶ O. BAR-GILL, ‘The Law, Economics and Psychology of Subprime Mortgage Contracts’, *Cornell. L. Rev.*, Vol. 94.(page 29 working paper).

¹⁷⁷ Both authors are sceptic with regard to behavioural law and economics theory, which they claim does provide not a sufficient basis for dominating legal policy regarding credit. See T. BROWN and L. PLACHE, ‘Paying with Plastic: Maybe Not So Crazy’, *Chi. L. Rev.*, Vol. 73, 64 and 86.

¹⁷⁸ Given the fact that consumers tend to do their shopping in different stores, some of them might accumulate the number ‘in-house credit lines’, what obviously mounts the difficulty to have a good overview on, among other things, monthly expenses resulting in more complexity. About the (cor)relation between loyalty programs and choice of payment, see also A.CHING and F. HAYASHI ‘Payment Card Rewards Programs and Consumer Payment Choice’, *Federal Reserve Bank of Kansas City Working Paper 06-02*, July 2006.

¹⁷⁹ See O. BAR-GILL, ‘Seduction by Plastic’, 98 *Nw. U. L. REV.*, 1373.

¹⁸⁰ D. DE MEZA, B. IRLENBUSCH and D. RYNIERS, ‘Financial Capability: A Behavioral Economics Perspective’, a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 29.



might prove awfully relevant with respect to overdraft facilities, bearing in mind the almost “tacit nature” of an overdraft¹⁸² and the possibility to make minimum payments. The absence of a number of barriers - both psychological as physical - typically influencing a consumer’s decision to spend (transaction function)¹⁸³ or to borrow (finance function), may explain both the overwhelming success as the risks linked to this particular type of credit. Credit card design resolutely seems to anticipate on this ‘urge for instant gratification’ or desire for instant consumption without having to bear instant costs.¹⁸⁴ Every transaction with a credit (or debit) card, implicates potential vocation on an overdraft facility.¹⁸⁵ One should link this tacit character to the phenomenon of cumulative cost neglect: a large number of small transactions will be perceived less harmful than a straight loan for the cumulative amount of this large number of transactions.¹⁸⁶

26. Finally, this cognitive bias possibly does one’s part in explaining why people fail to learn financial basics, to shop around, to read credit documentation, to engage in financial planning (all instant costs). Procrastination seems therefore equally to explain behaviour towards *remedies* as it explains the financial decision-making (or *cause*) itself.¹⁸⁷ Hyperbolic discounting goes together with both the over-optimism bias and the avoidance of emotional distress. Borrowers tend to be to over-optimistic about future credit needs and consequently also the costs that go with those needs. SHUI and AUSUBEL convincingly demonstrated that credit cards might be an enhancing factor for such consumer biases.¹⁸⁸

27. **“THE ROAD TO FINANCIAL DISTRESS IS PAVED WITH GOOD INTENTIONS”¹⁸⁹OR HOW BORROWERS SUFFER FROM BOUNDED WILLPOWER.** People often lack sufficient self-discipline, what could lead them to borrow, knowingly that such behaviour might jeopardize their own long- term interests.¹⁹⁰ Awareness of the potential dangers indeed seems to have little effect on this ‘reality-gap’¹⁹¹ between intentions and actual behaviour. Modern scholars increasingly pay attention to the bounded character of our willpower and phenomenon as ‘impulsiveness’, “weakness of the will” and time inconsistent behaviour. Such research focuses, among other things, on the existence of conflicts between our so-called “impulsive self” and our so-called “planner-self”.¹⁹² The planner-self’s desire to restrict harm caused by the “impulsive-self” could once more be a justification for a paternalistic intervention with regard to overdraft facilities. Numerous consumers associate the logo from Visa and Mastercard in a *pavlovian*

¹⁸¹ V. STANGO and J. ZINMAN, ‘How a Cognitive Bias Shapes Competition: Evidence from Consumer Credit Markets’, September 5, 2006), 12. Available at SSRN: <http://ssrn.com/abstract=928956>

¹⁸² ‘Losses’ are not directly felt by the creditor but buried under an abstract and difficult to ascertain A.P.R.

¹⁸³ J. SRIVASTAVA and P. RAGHUBIR refer for example to the notion of ‘an immediate pain’ when paying cash. See J. SRIVASTAVA and P. RAGHUBIR, ‘Debiasing Using Decomposition: the Case of Memory-Based Credit Card Expense Estimates’, *J. CONSUMER PSYCHOL.*, Vol. 12, 254.

¹⁸⁴ D. DE MEZA, B. IRLBUSCH and D. RYNIERS, ‘Financial Capability: A Behavioral Economics Perspective’, a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 24.

¹⁸⁵ O. BAR-GILL, ‘Seduction by Plastic’, 98 *Nw. U. L. REV.*, 1373.

¹⁸⁶ See C.R. SUNSTEIN, ‘Boundedly Rational Borrowing’, *Chi. L. Rev.*, Vol. 73, 251. The 2009 Statistics from Central Individual Credit Register learn that the average of the registered overdraft facilities amounts. When asked if they would engage in a straight loan for such sum, most registered borrowers will probably answer the negative. Overdraft facilities are far less visible and therefore obviously more dangerous for tacitly cumulating debt.

¹⁸⁷ D. de MEZA, B. IRLBUSCH and D. RYNIERS, ‘Financial Capability: A Behavioral Economics Perspective’, a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 30.

¹⁸⁸ SHUI and AUSUBEL, ‘Time Inconsistency in the Credit Market’, May 2005, available at <http://ssrn.com>.

¹⁸⁹ D. DE MEZA, B. IRLBUSCH and D. RYNIERS, ‘Financial Capability: A Behavioral Economics Perspective’, a study prepared for the Financial Services Authority (FSA), available at <http://www.fsa.gov.uk/>, 10.

¹⁹⁰ C. JOLLS, C. R. SUNSTEIN and R. THALER, ‘A Behavioral Approach to Law and Economics’, *Stan. L. Rev.*, Vol. 50, 1479. The Preparatory Documents of a law modifying the Belgian Law regarding Consumer Credit explicitly mentions this large freedom, demanding great discipline from consumers as one of the contributing factors of the dangerous nature of this kind of credit, that justifies legislation. See Doc. Parl. 2005-2006, n° 2260/01, page 6.

¹⁹¹ See A. C. GROMMET, *Economic Analysis*, CAMBRIDGE CONSUMER CREDIT INDEX, May 2005, 4.

¹⁹² A. SCHWARTZ, ‘Personal Bankruptcy Law: a Behavioural Perspective’, in NIEMI-KIESILAINEN, RAMSAY and WHITFORD(eds.), *Consumer Bankruptcy in a Global Perspective*, London, Hart, 2004, 66.



way with spending.¹⁹³ Evidence also suggests that consumers spend more when paying with a credit card than when paying cash.¹⁹⁴ A legal “commitment-device”, e.g. limiting (the amount) or banning (for certain categories of consumers) the possibility to occur an overdraft, as well as for example automatic deductions to savings accounts¹⁹⁵, could prevent that a seizure of power from consumers’ “impulsive-self” causes detriment to a borrower.¹⁹⁶

28. Most borrowers would applaud such “commitment-device”¹⁹⁷ as well as a more thorough inquiry about their financial intelligence before being granted credit.¹⁹⁸ Little surprising, sellers and creditors have less financial incentives to offer such device. Creditors try to shape consumer preferences on a continuous basis. The latter are no longer scarce when a consumer is offered the option to pay in ‘virtual currency’.¹⁹⁹ Random examples of worrying precedents are advertisements inciting to borrow e.g. for a holiday or a plasma TV. Such publicity might induce consumers to buy goods or services for the wrong reasons (e.g. keeping up with the joneses²⁰⁰) and without those goods or services necessarily promote their welfare (i.e. miswanting, or a situation where transactions’ outcomes in reality prove to be less satisfying than expected²⁰¹).²⁰² Monthly statements “informing” (seducing?) both systematic borrowers as mere transactors about the possibility to receive cash on their personal accounts only ‘by making one phone call’ might not be as innocent as they look.

D. Overdraft facilities and over-indebtedness.

29. **OVER-INDEBTEDNESS: A (EUROPEAN) PROBLEM?** Whereas the European average amounts to 13 percent, ‘only’ around 7 percent of the adult population in Belgium *totally* agrees with the statement “I have difficulties with paying all my bills at the end of the month”.²⁰³ Questioned if there is a risk of falling behind on consumer credit repayments, eighteen percent of the European citizens answers affirmatively.²⁰⁴ Almost a quarter of the European citizens fears

¹⁹³ See R.J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006, 48. Also Skinner’s Operant conditioning theory proves useful for an understanding of consumer behaviour with regard to overdraft facilities. Skinner observes that human behaviour can be modified by its outcome. The essence of overdraft facilities is however a postponement of such outcomes. Oren-BAR-GILL talks designates credit cards as ‘devices that encourage spending’. See O. BAR-GILL, ‘Seduction by Plastic’, 98 *Nw. U. L. REV.*, 1373.

¹⁹⁴ R.J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006, 46.

¹⁹⁵ I. RAMSAY, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets*, Oxford- Portland (Oregon), Hart Publishing, 2007, 73.

¹⁹⁶ AUSUBEL provides a funny anecdotal example of a particular commitment-device used by some American consumers to guard themselves against excessive borrowing: ‘sink your credit card in a box filled with water and put the latter in the freezer’. See L. M. AUSUBEL, ‘The Failure of Competition in the Credit Card Market’, *The American Economic Review*, Vol. 81, 72.

¹⁹⁷ For example with regard to unauthorized overdrafts, a large majority of the consumers would prefer a payment to be refused than incurring an unauthorized overdraft. A device at the point of sale informing the consumer about the fact his current account doesn’t allow to pay a purchased good or service without being overdrawn, and that leaves to consumer the choice whether to overdraw his account or to cancel the purchase would be applauded by many consumers. See OFFICE OF FAIR TRADING, ‘Personal current accounts in the UK. An OFT market study.’, 2008. Available at www.fsa.com Below similar commitment device will be outlined.

¹⁹⁸ Around 95 percent of the Belgian consumers questioned is favourable to a more stringent assessment of creditworthiness before being granted access to credit. See Report Eurobarometer 72.1 Poverty and Social Exclusion, February 2010, 104. Available at http://ec.europa.eu/public_opinion/archives/ebs/ebs_321_en.pdf

¹⁹⁹ Virtual money therefore creates ‘non-resource- constrained preferences’ that also explain a willingness to pay more for goods and services offered at the consumer. This might be an especially relevant incentive for non-financial creditors offering overdraft facilities as spending enhancing devices. See A. J. LEVITIN, ‘Priceless? The Social costs of credit card merchant restraints’, *Public Law & Legal Theory Working Paper Series*, Research Paper No. 973974, January 2008, 47, available at www.ssrn.com

²⁰⁰ For example in Belgium 23 percent of the over-indebted households indicated a standard of living superior to their financial means as a cause for their financial distress. See Observatoire du Cr dit et de l’endettement, *Rapport g n ral sur la consommation et le cr dit aux particuliers*, 2005.

²⁰¹ See S. BLOCK- LIEB, R. WIENER, J. A CANTONE and M. HOLTJE, ‘Disclosure as an Imperfect Means for Addressing Overindebtedness: An Empirical Assessment of Comparative Approaches’, in ‘; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 166.

²⁰² T. BROWN and L. PLACHE, ‘Paying with Plastic: Maybe Not So Crazy’, *Chi. L. Rev.*, Vol. 73, 76.

²⁰³ One should bear in mind that this is only a subjective angle for measuring over-indebtedness. See Eurobarometer 65.1 , February-March 2006. Around 18 percent of the questioned consumers in Belgium answered that they ‘tend to agree’ with the statement, again a percentage below the European average amounting 25 percent.

²⁰⁴ In Belgium 12 percent of the people questioned answers likewise. See Report Eurobarometer 72.1 Poverty and Social Exclusion, February 2010, 36. Available at http://ec.europa.eu/public_opinion/archives/ebs/ebs_321_en.pdf



the risk of becoming over-indebted.²⁰⁵ In 2009, nearly 16000 Belgians were granted a personal insolvency procedure.²⁰⁶ Financial distress implies significant costs for a debtor.

30. Numerous externalities could furthermore be observed, ranging from psychological distress in the household of a debtor (so-called harm in the second degree), social security constraints to the burden on our judicial system.²⁰⁷ Social, financial and market exclusion lure around the corner of debt.²⁰⁸ A careful reader shall therefore -with us- endorse the view that over-indebted citizens are a public stigma, challenging our modern welfare state. As the Single Market increasingly will contribute to our “credit society”, European policy shouldn’t be blind for the downsides that consumer credit could bring along for households.²⁰⁹ Deleverage is needed.²¹⁰ Over-indebtedness mustn’t be tolerated in the twenty-first century and without doubt could not be but an European priority.²¹¹

31. **OVERDRAFT FACILITIES AND OVER-INDEBTEDNESS: LOVE AT FIRST SIGHT?** The insight that overdraft facilities might be a contributing factor to financial distress could hardly be categorized as innovative.²¹² Personal insolvency filing rates are strongly correlated with the amount of consumer credit debt.²¹³ The tale of over-indebtedness, i.e. *a temporary or permanent disequilibrium in the budget of a household resulting from expected or unexpected expenditure increases or from the household’s income decreases*²¹⁴, is however more ambiguous and largely exceeds overdraft facilities and consumer credit in general.²¹⁵ The *exact* relationship between consumer credit and personal insolvency is food for further research.²¹⁶ In 2009, more than 30% percent of the Belgian consumers ‘granted’ a personal insolvency procedure²¹⁷ weren’t registered as (defaulting) borrowers.²¹⁸ Consumer credit is

²⁰⁵ 27 percent of the Belgian citizens questioned indicated that they share this opinion, which corresponds with the European average. See Report Eurobarometer 72.1 Poverty and Social Exclusion, February 2010, 32. Available at http://ec.europa.eu/public_opinion/archives/ebs/ebs_321_en.pdf

²⁰⁶ See the 2009 Statistics from Central Individual Credit Register, 61. A significant increase compared with 2006, where almost 12000 consumers were ‘eligible’ for a personal insolvency procedure.

²⁰⁷ N. HULS and others, *Overindebtedness of consumers in the EC member states: facts and search for solutions*, Diegem, Kluwer éditions juridiques, 1994, 206.

²⁰⁸ See C. FRADE and C. ABREU LOPES, ‘Over indebtedness and Financial Stress: A Comparative Study in Europe’, in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer Credit, Debt & Bankruptcy. Comparative and International Perspectives*, Oxford and Portland, Oregon, Hart Publishing, 2009, 249 and references there, U. REIFNER, ‘A call to Arms’- For Regulation of Consumer Lending’, in J. NIEMI, I. RAMSAY and W. C. WHITFORD, *Consumer Credit, Debt & Bankruptcy. Comparative and International Perspectives*, Oxford and Portland, Oregon, Hart Publishing, 2009, 105.

²⁰⁹ N. HULS and others, *Overindebtedness of consumers in the EC member states: facts and search for solutions*, Diegem, Kluwer éditions juridiques, 1994, 203.

²¹⁰ In 2008 the outstanding consumer credit debt as percentage of GDP was 6 percent in Belgium. The European average was almost 10 percent. See DG HEALTH AND CONSUMER PROTECTION, ‘Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection. Final Report’, November 2009, 20.

²¹¹ See Council of Europe, Committee of Ministers Recommendation (2007) 8^E on legal solutions to debt problems, June 20, 2007.

²¹² R. J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006, 45.

²¹³ D. ELLIS, ‘The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and Personal Bankruptcy Rate’, *Bank Trends*, March. 1998, 1.

²¹⁴ See ‘Towards a Common Operational European Definition of Over-indebtedness’, report prepared for the EC D-G Employment, Social Affairs and Equal Opportunities, 2008, 5. It should be noticed here that no accepted universal definition of over-indebtedness exists. See S. BLOCK- LIEB, R. WIENER, J. A. CANTONE and M. HOLTJE, ‘Disclosure as an Imperfect Means for Addressing Overindebtedness: An Empirical Assessment of Comparative Approaches’, in ‘; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 154.

²¹⁵ M. DE MUYNCK, ‘Consumentenkrediet: Richtlijn 2008/48/EG en de Belgische Uitdaging’, *D.C.C.R. (Droit de la consommation-Consumentenrecht)*, 2009, n° 2, 38.

²¹⁶ Some literature, that fails to incorporate the necessary reticence and draws conclusions without supporting evidence, should therefore be observed with a dose of scepticism. See I. RAMSAY, ‘Consumer Credit Society and Consumer Bankruptcy’, in J. NIEMI-KIESILÄINEN, I. Ramsay and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 19 and 31.

²¹⁷ In Belgium, the criterion for being eligible for a insolvency procedure (to be declared insolvent) is the fact that one’s income does not allow to pay in a sustainable way debts due, without this insolvency clearly can be blamed to the applicant. See Article 1675/2 Belgian Judicial Code.

²¹⁸ See the 2009 Statistics from Central Individual Credit Register. Around 22 percent of those consumers had no credit agreement running; around 10 percent had (a) contract(s) without default status. Of course, one can also perceive those figures in a more ‘the glass is half empty’ way: around 70 percent of those applying for a personal insolvency procedure were defaulting in at least one credit relation.



therefore by no means a *sine qua non* for financial distress.²¹⁹ Adverse financial events (e.g. job-loss, illness- notwithstanding social security- triggering important expenses,..) hold a prominent place in explaining over-indebtedness.²²⁰ Bearing foregoing nuance in mind, we examine how overdraft facilities might be a *contributing* factor to financial distress. Some peculiar overdraft facility characteristics could be linked with common cited causes for over-indebtedness.²²¹ Both the *borrowing as transaction* function from cards seem important but distinct factors : while the latter does it's part in explaining 'overspending', the borrowing function might enhance its adverse consequences.

32. FINANCIAL OBESITIES. SLIDING IN TO DEBT.²²² Attitudes towards spending are seen as highly predictive factors towards financial distress.²²³ We learned that the absence of some barriers that typically influence a consumer's decision whether to purchase a good or service, entices consumers who suffer from buying moods to spend more when paying with a credit card than when paying cash. We argued that advertising and non-financial benefits try to shape consumers' preferences on a continuous basis, that finance services often are subservient to the sale of goods and services and that instalment credit is increasingly 'disguised' as an overdraft facility, enabling consumers to finance subsequent purchases or even to take up cash. Consumers are moreover often troubled to recollect past transactions, preventing them from outlining accurate money-management schemes (see nr. 22). We also saw that consumers are not always able to distinct mere transacting from borrowing and credit therefore occurs unintentional, even unconsciously. All these observations correspond with evidence suggesting that (increased) convenience use contributes to (an increased number of) debt.²²⁴

33. THE "HANGOVER". HANGING OVER TO CREDIT: THE STIFF CLIMB OUT OF DEBT. We started this contribution with the postulate that substitution of income by credit more and more becomes mainstream for many consumers. Debt as such is not automatically wrong, nor detrimental: rational consumers continuously face trade-offs between saving and dissaving. Notwithstanding the fact that refraining from refinancing expensive overdraft debt strikes us as less rational, we saw that overdraft borrowers often suffer from financial conservatism. Complexity explains, among other things why many consumers focus on monthly payments instead of A.P.R. and content themselves by only making minimum payments . Little attention is given to the ultimate cost of credit.²²⁵ Especially salient for overdraft facilities, typically used to borrow numerous small amounts, is that the size of a single borrowing transaction is deemed to be an important predictor for A.P.R. awareness.²²⁶ Borrowers moreover often fall victim to over-optimism and hyperbolic discounting, both promoting unrealistic (rosy)views about their future income and behaviour. They might get 'lured' to the short-term aspects of borrowing (See nr. 24).

Bounded willpower explains a reality-gap between financial intentions and actual

²¹⁹ See K.M. PORTER, 'The Debt Dilemma', *Mich. L.Rev* (Michigan Law Review), Vol. 106, 1175.

²²⁰ See K.M. PORTER, 'The Debt Dilemma', *Mich. L. Rev.*, Vol. 106, 1177 and the following. The author criticizes some scholars' omission to incorporate those external factors in their research.

²²¹ See 'Towards a Common Operational European Definition of Over-indebtedness', report prepared for the EC D-G Employment, Social Affairs and Equal Opportunities, 2008, 23-28.

²²² Over-indebtedness is a process. Often a history of various events triggering financial distress. See J. NIEMI, 'Overindebted Households and Law: Prevention and rehabilitation in Europe', in J. NIEMI, I. Ramsay and W. C. WHITFORD, *Consumer Credit, Debt & Bankruptcy. Comparative and International Perspectives*, Oxford and Portland, Oregon, Hart Publishing, 2009,92.

²²³ See 'Towards a Common Operational European Definition of Over-indebtedness', report prepared for the EC DG Employment, Social Affairs and Equal Opportunities, 2008, 22.

²²⁴ See K. W. JOHNSON, 'Convenience or Necessity? Understanding the Recent Rise in Credit Card Debt', Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board Washington D.C., Staff working paper 2004-47.

²²⁵ A.M. DICKERSON, 'Consumer Over-Indebtedness: A U.S. Perspective', *Tex.Int'l L.J.* (Texas International Law Journal), Vol. 43, 138.

²²⁶ W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.* (Wisconsin Law Review), 1973, 407.



behaviour. Again, these observations support the idea that overdraft debt, besides more expensive, might also be more harmful than other types of consumer debt. Being disorganized and displaying a relaxed approach to financial management are deemed to be important- but largely underestimated - factors contributing to over-indebtedness.²²⁷

Hyperbolic discounting could explain why a number of indebted consumers (e.g. defaulting on energy bills, rent, etc.) is prepared to transform such short-term debt into long-term debt by vocation on an overdraft facility. Notwithstanding late payments will be avoided by using the facility, the consumer's future burdens only enlarge. Overdraft facilities might therefore *postpone* but *not avoid* personal insolvency.²²⁸ LAWLESS reveals an interesting paradox: however there is no doubt that debt causes personal bankruptcies, in the short-term consumer credit (debt) seems to be a factor preventing households from going broke.²²⁹ Credit cards and overdraft facilities fulfil a "lender of last resort" function on the micro-level.²³⁰ Again, one should be careful not to overestimate consumers' rational behaviour.²³¹ Research reveals that the *total amount* of money borrowed is much less important in explaining financial distress of a household than the *number* of its credit commitments.²³² Such findings question the European Consumer Credit Directive's- discretionary - criteria to determine which credit agreements are subject to its prescriptions (see further).

E. Conclusion: do asymmetries in the market for consumer credit, imperfect rationality, biases and heuristics lead to an unjustified distortion of the theory of equal bargaining power between creditors and consumers?

34. **MARKET DISTORTIONS.** In part I (B) we observed that informational market power may explain why creditors seem to enjoy a free ticket to offer credit on onerous terms (see nr. 16), that financial incapable consumers are poorly armed to discipline the market and that a failure to shop around, enhanced by cross-selling and product tying strategies (see nr. 14) helps to explain low consumer mobility in the market for consumer finance (financial conservatism). Credit's product characteristics reduce moreover the informed minority's ability to advocate changes for their more vulnerable counterparts, paving the way for increased lenders' ability to price-discriminate. These factors may contribute to one sided - to borrowers detriment - dictated credit terms.²³³ Market-segmentation may also partly explain why onerous terms fail to cause reputational harm to creditors.²³⁴

35. **CONSUMERS' PATTERN (AB)USE.** Doing business with irrational, ignorant and vulnerable consumers (see part I (C)) proves highly profitable for creditors.²³⁵ Both the charges due for an overdraft borrower, as the materialized gains for a creditor are functions of the *use-pattern*

²²⁷ See 'Towards a Common Operational European Definition of Over-indebtedness', report prepared for the EC D-G Employment, Social Affairs and Equal Opportunities, 2008, 25.

²²⁸ R.L. LAWLESS, 'The Paradox of Consumer Credit', *U.Ill.L.Rev.*(University of Illinois Law Review), Vol. 2007, 347.

²²⁹ R.L. LAWLESS, 'The Paradox of Consumer Credit', *U.Ill.L.Rev.*, Vol. 2007, 349.

²³⁰ See I. RAMSAY, 'Consumer Credit Society and Consumer Bankruptcy', in J. NIEMI-KIESILÄINEN, I. RAMSAY and W.C. WHITFORD, *Consumer Bankruptcy in Global Perspective*, Oxford, Hart, 2003, 30 referring to the following Canadian study: Informetrica, *Consumer Bankruptcies: Contributing Key Factors*, Ottawa, 1999.

²³¹ Some authors strongly focus on how legal changes with regard to bankruptcy laws influence opportunistic consumers' spending. Others ascertain for example that moral hazard might explain the occurrence of a 'cat-bounce'-effect : when a consumer is almost bankrupt, the amount of consumer credit taken by a financial disturbed consumer might take a final hike. However such effect could be especially relevant for overdraft borrowers (since the facilities' revolving character) one should be careful and avoid to overestimate consumers' masterminds. See for example R.L. LAWLESS, 'The Paradox of Consumer Credit', *U. Ill. L. Rev.*, Vol. 2007, 366. For a critic, see R.J. MANN, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge, Cambridge University Press, 2006, 183-185.

²³² Almost one out of ten Belgian consumers applying for personal insolvency in 2009 were registered with at least five (!) defaulting contracts. See the 2009 Statistics from Central Individual Credit Register, 60.

²³³ M. SCHILLIG, 'Inequality of bargaining power versus market or lemons: Legal paradigm change and the Court of Justice's jurisprudence on Directive 93/13 on unfair contract terms', *E.L. Rev.*, June 2008, 338.

²³⁴ O. BAR-GILL, 'Informing Consumers About Themselves', *Law & Economics Research Paper Series Working Paper N° 07.-44*, 11.

²³⁵ A.M. DICKERSON, 'Consumer Over-Indebtedness: A U.S. Perspective', *Tex. Int'l L.J.*, Vol. 43, 153.



of a particular facility.²³⁶ It is common practice that a business benefits from an advanced knowledge about consumer patterns. Supermarkets' fidelity cards are an obvious example. Nonetheless, a distinct line should be drawn between a mere *use* of superior information and its *abuse*. "Behaviour driven pricing"²³⁷ or instalment credit 'disguised' as an overdraft facility show that creditors have learned to exploit consumers' cognitive limitations.²³⁸

Based on the financial industries' own statistics about use patterns, predictions - often more accurate than the consumer his own prediction - of how particular categories of borrowers will (mis)use their credit are developed.²³⁹ Financial contracts are systematically adapted at patterns deviating from perfect rationality²⁴⁰ in order - as a former financial employee puts it - "*to built an entire sale on confusion*".²⁴¹ The fact that credit is a school example of a *credence* good only adds to the detriment suffered by some borrowers and their households. Lenders have - at least theoretically - an incentive to preserve or even to intensify biases, heuristics and consumer ignorance since there is a lot of money in it.²⁴²

Freedom of contract can never be used as an excuse for scenarios where the strong exploit the weak, whatever might cause this inequality.²⁴³ If a consumer's conception about the future consequences of a credit agreement proves terribly wrong, the normative power of the freedom of contract paradigm is significantly handicapped.²⁴⁴

36. ACKNOWLEDGING THAT THERE IS A NEED FOR LEGISLATIVE INTERVENTION IS AN OBVIOUS – HENCE NOT TRIVIAL - STARTING POINT FOR EVERY MEASURE WITH REGARD TO CONSUMER PROTECTION.²⁴⁵ Early in this contribution we observed that the fact that consumer credit is much more heavily regulated than other (consumer) agreements, didn't occur without reason. Market distortion is a necessary but insufficient rationale for (consumer)policy intervention.²⁴⁶ Market outcomes don't necessarily correspond with optimal social benefit equilibriums. Markets' results are only admissible to the extent that they -on the long run-benefit society's least-advantaged members.²⁴⁷ Moral constraints nor a "*deep-rooted tradition of suspicion towards bankers*"²⁴⁸ are sufficient rationales for legal intervention. Law ought only to police those moral standards that are deemed to be essential pillars of the society in which it is applicable.²⁴⁹

37. We are convinced that credit regulation is a particularly essential pillar of our welfare state model, where 'wealth is made up largely of promises'.²⁵⁰ European law's aim to create

²³⁶ O. BAR-GILL, 'Informing Consumers About Themselves', *Law & Economics Research Paper Series Working Paper* N° 07.-44, 1.

²³⁷ I. RAMSAY, 'Consumer credit regulation as 'The third way'?', Keynote speech at. Australian Credit at the Crossroads. **Conference**, 8 November 2004, Melbourne, 18.

²³⁸ O. BAR-GILL and E. WARREN, 'Making Credit Safer', *U. Pa. L. Rev.*, Vol. 157, (101) 106.

²³⁹ O. BAR-GILL and E. WARREN, 'Making Credit Safer', *U. Pa. L. Rev.*, Vol. 157, (101) 123.

²⁴⁰ O. BAR-GILL, 'Seduction by Plastic', 98 *Nw. U. L. REV.*. 1373.

²⁴¹ Equity Predators: Striping, Flipping and Packing their way to Profits: Hearing Before the S. Special Comm. On Aging, 105th Cong. 31-37 (1998).

²⁴² A. SCHWARTZ, 'Personal Bankruptcy Law: a Behavioural Perspective', in NIEMI-KIESILAINEN, RAMSAY and WHITFORD, eds., *Consumer Bankruptcy in a Global Perspective*, London, Hart, 2004, 71.

²⁴³ O. LANDO, 'Liberal, social, and 'ethical' justice in European contract law', *CML Rev.* (Common Market Law Review) 2006, 822.

²⁴⁴ O. BAR-GILL, 'Seduction by Plastic', 98 *Nw. U. L. REV.*. 1373.

²⁴⁵ See S. ISSACHAROFF and I. J. SAMUEL, 'The Institutional Dimension of Consumer Protection', *NYU School of Law, Public Law Research Paper No. 09-18*.

²⁴⁶ Perfect markets only occur in Utopia. Nevertheless one can imagine numerous *imperfect* markets where policy intervention is redundant. See I RAMSAY, *Rationales for Intervention in the Consumer Marketplace*, Occasional Paper, Office of Fair Trading, London, 15 and following.

²⁴⁷ This idea was developed by J. RAWLS. See I. RAMSAY, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets*, Oxford- Portland (Oregon), Hart Publishing, 2007, 34.

²⁴⁸ E. WYMEERSCH, 'Bank Liability for improper credit decisions in the civil law', in CRANSTON, R. (ed.), *Banks, Liability and risk*, London, Lloyd's London press, 1995, 184.

²⁴⁹ J. HÄYHÄ, 'Scandinavian Techniques for Controlling Fairness in Contracts', in R. BROWNSWORD, G. HOWELLS and T. WILHELMSSON (eds.), *Welfarism in contract law*, Dartmouth 136.

²⁵⁰ P.S. ALTIYAH, 'Scandinavian Techniques for Controlling Fairness in Contracts', in R. BROWNSWORD, G. HOWELLS and T. WILHELMSSON (eds.), *Welfarism in contract law*, Dartmouth, 2. (Citing R. Pound)



‘financial citizens’²⁵¹ shows similarities with the objectives of democratic participation: the ability to make a free, and well-informed choice is central to both, as also the fact that a policy failure in both cases leads to social exclusion.²⁵² On the other hand, too easy access to credit may be welfare reducing as well, given concerns that easy credit could induce consumers to purchase goods and services that they value less than their actual price (i.e. the *credit price*, this is the price that includes the cost of borrowing).²⁵³

While policing market efficiency, consumer credit regulation - situated at the crossroad between private and public law²⁵⁴ ought to safeguard some key social values. Conceptions of fairness should not only entail the protection of consumers against creditor malpractice but equally safeguard consumers from self-caused harm through behaviour diverging from (perfect) rationality. Notwithstanding similar conception of fairness is rarely questioned in the field of product (liability) law, hesitance exists to extend such reasoning to the field of consumer finance. Whereas nobody for example will argue that pharmaceutical consumers are to blame for their failure to comprehend all too complex ‘medicalese’ information, warning them for the dangerous side-effects that a particular unsuitable medicine could trigger, borrowers are all in all often blamed for their inability to choose the right type of credit. If the law prevents risk-full behaviour in the field of medicine, why then does the same institution fails to discourage consumers to over engage themselves by taking up too much credit?²⁵⁵ Not that the latter remark implicates that borrowers should be exonerated from any responsibility: responsible *credit* and responsible *borrowing* are indiscernible from each other. Welfare opportunism (i.e. riskier behaviour caused by the welfare state’s cushion e.g. personal insolvency regimes) should be avoided.²⁵⁶

38. In *Oceano Grupo*, the ECJ acknowledged that unequal bargaining power leads consumers to agree with terms drawn up by a business without being able to influence their content.²⁵⁷ By omitting to incorporate some -above outlined- behavioural truth about *homo sapiens* consumers in its reasoning, such judgement only partly catches today’s reality with regard to consumer finance. Judges nor policymakers should be selectively blind for numerous consumers’ inability to grasp a sufficient understanding of transactions in our modern society. This is all the more the case for complex financial products such as overdraft facilities, that might involve important downsides for vulnerable consumers, fallen prey to materialistic obesity without sufficient financial means to cope.

When desperately in need of money, people might be willing to lend on whatever terms a loan is available for them.²⁵⁸ In many cases no judicial red lights prevent consumers from transacting, nor are creditors prohibited to throw credit offers - that induce financial irresponsible behaviour - at consumers. MIFID’s “know your customer rules” may lead financial institutions to refrain from executing a transaction if proceeding otherwise could negatively affect an investor’s assets.²⁵⁹ In its article 15, the Belgian Consumer Credit Code introduces a similar duty to refrain from a transaction in

²⁵¹ GRAY and HAMILTON, *Implementing Financial Regulation: Theory and practice*, Wiley, 2006, n°2, Ch. 6.

²⁵² PEARSON, ‘Financial Literacy and the Creation of Financial Citizens’, in KELLY-LOUW, NEHF and ROTT (eds.), *The Future of Consumer Credit Regulation. Creative Approaches to Emerging Problems*, Ashgate, Hampshire, 2008,5. Earlier we observed that biases and heuristics especially seem to affect ‘weaker’ members of our society.

²⁵³ O. BAR-GILL, ‘Informing Consumers About Themselves’, *Law & Economics Research Paper Series Working Paper N° 07.-44*, 11.

²⁵⁴ C. I. GARCIA PORRAS and W. H. VAN BOOM, ‘Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations’, *Rotterdam Institute of Private Law Working Paper*, December 2009, 5.

²⁵⁵ See E. POSNER, ‘Contract Law in the Welfare State: A defense of the unconscionability doctrine, usury laws, and related limitations on the freedom to contract.’, *J. Legal Stud.* (Journal of Legal Studies), 1995, 301.

²⁵⁶ See E. POSNER, ‘Contract Law in the Welfare State: A defense of the unconscionability doctrine, usury laws, and related limitations on the freedom to contract.’, *J. Legal Stud.* 1995, 286.

²⁵⁷ *Oceano Grupo Editorial SA v Rocio Murciano Qintero*, ECJ June 27 2000, C-240/98 to C244/98 (joined cases).

²⁵⁸ This extreme example of inequality of bargaining power (that besides food also might prove relevant for basic services as electricity or natural gas) contrasts with other consumer agreements and was acknowledged in the Final Report on Consumer Credit prepared by the Crowther Committee, 1971, , n° 6.1.2. point (i), 233 and n° 6.1.8 (inadequate income).

²⁵⁹ See Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, *O.J. L.* 30 April 2004, 145/1 (hereafter referred to as ‘MIFID’)



the field of consumer finance: a creditor is not allowed to extend credit unless he reasonably could assess that the borrower will be able to meet his obligations under the contract.²⁶⁰

39. The European Community undoubtedly achieved a level of consumer protection which is higher than it was ever before. This merit should not implicate a standstill. Today's level of consumer protection in the field of consumer finance is still insufficiently high.²⁶¹ While equipping consumers with ample skills to survive in a sophisticated financial environment²⁶², policy should exceed narrow legal reasoning and incorporate ethical, economical and social norms.²⁶³ Classic legislations' inability to keep pace with complex and fast evolving practices on the market for consumer credit (see nr. 16) indeed call for intelligent, multi-layered regulation.²⁶⁴

II. OVERDRAFT FACILITIES AND DISCLOSURE: A SUITABLE MEANS TO ENLIGHTEN BORROWERS?

“Il ne peut nous être permis de lui (la partie avec qui l'on contracte) rien cacher de ce que nous n'aurions pas voulu que l'on nous cachât, si nous eussions été à sa place”²⁶⁵

A. European Consumer Credit Directive

40. **INTRODUCTION.** Both American²⁶⁶ and European lawmakers primarily focus on information requirements as - little innovative - means to protect financial consumers. The ECJ ruling in the *Cassis de Dijon* case²⁶⁷ is traditionally²⁶⁸ marked as root for European disclosure laws aimed at the encouragement of consumer autonomy through the formation of better informed, educated and hence *confident* consumers.²⁶⁹ An internal market characterized by an informational equilibrium between on the one hand consumers and sellers on the other hand, is emphasized by both the European Treaty²⁷⁰ and the EU Consumer Policy Strategy 2007-2013.²⁷¹ Information requirements are said to be the least intrusive instrument to enhance consumer welfare.²⁷²

This belief is also the red thread through the 'new' Consumer Credit Directive, largely

²⁶⁰ See article 15 Belgian Consumer Credit Code.

²⁶¹ O. LANDO, 'Liberal, social, and 'ethical' justice in European contract law', *CML Rev.* 2006, 823.

²⁶² And for example induce them to be sensitive for deleverage. See Pearson, 'Financial Literacy and the Creation of Financial Citizens', in KELLY-LOUW, NEHF and ROTT (eds.), *The Future of Consumer Credit Regulation. Creative Approaches to Emerging Problems*, Ashgate, Hampshire, 2008,3.

²⁶³ See U. REIFNER, 'A call to Arms'- For Regulation of Consumer Lending', in J. NIEMI, I. RAMSAY and W. C. WHITFORD, *Consumer Credit, Debt & Bankruptcy. Comparative and International Perspectives*, Oxford and Portland, Oregon, Hart Publishing, 2009, 106.

²⁶⁴ J. HÄYHÄ, 'Scandinavian Techniques for Controlling Fairness in Contracts', in R. BROWNSWORD, G. HOWELLS and T. WILHELMSSON (eds.), *Welfarism in contract law*, Dartmouth, 145.

²⁶⁵ R. J. POTHIER, *Traité des obligations*, n° 130

²⁶⁶ The **Truth in Lending Act** (TILA) of 1968.

²⁶⁷ ECJ Case 120/78, *Cassis de Dijon*, 1979, ECR 649. See paragraph 13 where the Court expressed the view that information rules – that doesn't intervene in the contractual relation - are to be preferred over mandatory rules that prescribe substantive regulation whenever this is possible.

²⁶⁸ See for example M. EBERS, 'INFORMATION AND ADVISING REQUIREMENTS IN THE FINANCIAL SERVICES SECTOR: Principles and Peculiarities in EC Law', *Electronic Journal of Comparative Law*, Vol. 8.2, June 2004, 2.

²⁶⁹ The Sutherland report concluded that 'confident consumers' are an essential precondition for a smooth functioning internal market. See 'Le Marché Intérieur après 1992: répondre au défi. Rapport présenté par le Groupe à haut niveau sur le fonctionnement du marché intérieur.' (Sutherland report).

²⁷⁰ This idea could be read in article 169 TFEU 'In order to promote the interests of consumers and to ensure a high level of consumer protection, the Union shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organise themselves in order to safeguard their interests.'

²⁷¹ EU Consumer Policy Strategy 2007-2013 Empowering Consumers COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, enhancing their welfare, effectively protecting them, COM (2007), 99 Final. Available at http://ec.europa.eu/consumers/overview/cons_policy/doc/EN_99.pdf

²⁷² See G. HOWELLS and T. WILHELMSSON, 'EC Consumer Law: Has it Come of Age', *ELRev*, Vol. 4, 380.



pre-empting national consumer credit policies.²⁷³ Borrowers are deemed to understand the information – in general confining itself to the main characteristics of the proposed credit agreement²⁷⁴ - that lenders mandatory have to disclose.²⁷⁵

Apart from the question whether many borrowers do shop around for credit (see nr. 11), serious doubts were raised about both the *capacity* and *willingness* of consumers to absorb such flood of information while purchasing credit, all in all an abstract legal product (see nr. 10). If the assumption that a significant amount of borrowers either (1) *doesn't consume* the information, (2) *fails to understand* the disclosed information (3) *nor acts upon it*²⁷⁶ is correct, the pursued informational equilibrium devaluates in essence to - high-priced²⁷⁷ - Eurocratic reasoning.²⁷⁸

41. Policymakers' inability to induce consumers to include vital information in their decision-making process²⁷⁹ is said to entail a *laissez-faire* contract paradigm to consumers detriment.²⁸⁰ While today's disclosure is aimed at the enlightenment of "less-than-perfectly informed borrowers",²⁸¹ mere suffering from a lack of knowledge about a particular type of credit they wish to purchase, the first part of this contribution endorses the view that regulation might have to descend a step further on the ladder of (ir)rationality by incorporating imperfect borrowers' knowledge about own – sometimes biased - behaviour.

Before discussing how information requirements' effectiveness could be optimized with regard to overdraft facilities²⁸², we observe *some*²⁸³ flaws contributing to the current sub-optimal protection level of *non-professional*²⁸⁴ borrowers under the Directive (hereafter referred to as 'CCD'). After this exercise we shortly explore the Belgian informational regime

²⁷³ See S. M. FRANKEN, 'The Political Economy of the EC Consumer Credit Directive'; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 130. This author argues that the Consumer Credit Directive's targeted maximum harmonisation character should be understood in a pro-integrationist agenda. The harmonization character should equally be read as a prohibition for member states to introduce more protective -consumer friendly measures. also See for example ECJ 25 April *Gonzales Sanchez*, 2002, C-1380/00, Jur. 2002, I- O3901.

²⁷⁴ Disclosure regulation indeed confines itself mainly to information requirements regarding *product* characteristics of a particular credit proposed offered. Starting from some behavioural biases, further we will argue that to be effective, disclosure regulation should also enlighten borrowers about (their own) behaviour regarding a particular type of credit.

²⁷⁵ C. I. GARCIA PORRAS and W. H. VAN BOOM, 'Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations', *Rotterdam Institute of Private Law Working Paper*, December 2009, 4.

²⁷⁶ F.M. A. 'T HART en C.E. DU PERRON, *De geïnformeerde consument. Is informatieverstrekking een effectief middel om consumenten afgewogen financiële beslissingen te laten nemen?*, Preadvies voor de Vereniging voor Effectenrecht 2006, Van Der Heijden Instituut, Kluwer, Deventer, 2006, 105.

²⁷⁷ In the UK, a recent study estimated information requirements' costs (broader than consumer credit regulation) at 1.5 billion Pound. See 'Warning: Too much information can harm. A final report by the Better Regulation Executive and National Consumer Council on maximizing the positive impact of regulated information for consumers and markets.', Better Regulation Executive and National Consumer Council, November 2007, 6.

²⁷⁸ C. I. GARCIA PORRAS and W. H. VAN BOOM, 'Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations', *Rotterdam Institute of Private Law Working Paper*, December 2009, 8.

²⁷⁹ LUTH, H. A., 'Extending the scope of the Unfair Terms discipline in consumer contracts- an economic and behavioural perspective', *Rotterdam Institute of Law and Economics Working Paper Series*, No 2008/01, 3.

²⁸⁰ Some even ascertain that disclosure laws are enacted especially given the knowledge of their limited impact. See W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.*, 1973, 436. Within its scope, the consumer credit directive's maximum harmonization character entails a decline of borrowers' protection in some Member states.

²⁸¹ S. BLOCK- LIEB, R. WIENER, J. A CANTONE and M. HOLTJE, 'Disclosure as an Imperfect Means for Addressing Overindebtedness: An Empirical Assessment of Comparative Approaches', in ; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 153.

²⁸² The current Consumer Credit Directive is indeed no end point in the European Union's efforts to protect borrowers. See for example consideration 44 stating that 'In order to ensure market transparency and stability, and **pending further harmonisation**, Member States should ensure that appropriate measures for the regulation or supervision of creditors are in place.'

²⁸³ Within the scope of our contribution, by no means we attempt to provide a comprehensive overview of the informational regime installed by this Directive, but limit ourselves to some- what we believe to be- striking shortcomings.

²⁸⁴ One could wonder if a strict dichotomy between consumers (i.e. ' every natural person acting for purposes which are outside their trade, business or profession- see article 3.a Consumer Credit Directive) and those not allowed to benefit from such favourable label is justified. A worn-out example is that from the law professor enjoying enhanced protection in the field of consumer finance v. the (illiterate) plumber, both concluding the same agreement. Imperfect rationality is not characterized by similar stringent borders. The diffidence to draw (new) boundaries might not incite policymakers to refrain from action. See C. CAMERER, S. ISSACHAROFF, G. LOEWENSTEIN, T. O'DONOGHUE and M. RABIN, 'Regulation for conservatives: behavioral economics and the case for 'asymmetric paternalism'', *U. Pa. L. Rev.* , Vol. 151, 1252.



with regard to overrunning for those agreements that fall out the Belgian Consumer Credit Code(B.).

42. The CCD establishes a double layer of pre-contractual disclosure. Besides prescriptions with regard to credit advertisement²⁸⁵, it requires creditors and/or credit intermediaries to provide pre-contractual information. Such pre-contractual information must be provided through a European Standard Information Form (see nr. 43) and *in good time before a consumer is bound by a credit agreement or offer*.²⁸⁶ Given earlier concerns raised about non-financial institutions that literally throw overdraft facilities at consumers' head at the point of sale, in order to induce them to purchase goods and/or services, we look with Argus' eyes at the transposition measures and supervision in this regard.²⁸⁷ A cooling-off period could largely contribute to the prevention of harm caused by impulsive buying /credit decisions, e.g. in case when a consumer, while shopping in his supermarket is seduced to buy a plasma TV (i.e. a 'situational [credit] monopoly'²⁸⁸).

43. **EUROPEAN STANDARD INFORMATION FORM** . In the pre-contractual stage a comprehensive amount of information has to be provided through a *European Standard Information Form*.²⁸⁹ This document is said to contain the most important features of the proposed credit agreement in order to prevent consumers being distracted by other – less important-information. In addition to the risk that an information overload could exacerbate complexity,²⁹⁰ the standard information form fails to inform about potential risks of over-indebtedness,²⁹¹ nor does it provide information about an optimal use of credit.²⁹² It's also worth while to point out that for credit offered – at the consumer's request - through means of distance telecommunication (e.g. credit by text message or “SMS cash”, credit offered on the internet,..), the European Standard Information Form could be provided '*immediately after*' the conclusion of the credit agreement.²⁹³ Such broad interpretation of the notion pre-contractual information, despite rightful concerns that similar – barrier reducing - channels might especially attract financially troubled consumers who search to apply 'anonymously' for credit, among other things in order to avoid the embarrassment upon refusal, is regrettable.²⁹⁴

²⁸⁵ The CCD provides a list of information to be provided in '*any advertising concerning credit agreements which indicate an interest rate or any figures relating to the cost of credit*'.(see article 4 CCD). Unfortunately, the requirement to provide the information in a particular order didn't survive the European Parliament. Such obligation would benefit comparison between different credit offers. See P. ROTT, 'Consumer Credit' in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 192.

²⁸⁶ See article 5 (1) CCD and article 6 (1) with regard to overdraft facilities. It should be noted that Mifid equally requires information to be required 'in good time before the conclusion of the agreement' and also includes and exception for distance services (see article 29 (5) Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *O.J. L. 2* September 2006, 241/26.

²⁸⁷ A UK survey learns that half of the store card borrowers made their decision to apply for such store card whilst talking to a staff member. See BIS, 'A Better Deal for Consumers. Review of the Regulation of Credit and Store Cards: Government Response to Consultation.', March 2010, 30. The fact that a consumer, while shopping could be 'taken by surprise' to sign up for credit, was one of the rationales provoking the enactment of a right of withdrawal in article 14 of the Consumer Credit Directive. On the right of withdrawal, see E. TERRY, *Bedentijden in het consumentenrecht : het herroepingsrecht als instrument van consumentenbescherming*, Antwerpen, Intersentia, 2008.

²⁸⁸ See P. REKAITI and R. VAN DEN BERGH, 'Cooling-Off periods in the Consumer Laws of the EC Member States. A Comparative Law and Economics Approach', *Journal of Consumer Policy*, Vol. 23, 371.

²⁸⁹ See article 5(1) and 6 (1) CCD (in case of an overdraft facility).

²⁹⁰ Article 6 (1) prescribes for example that not less than 12 issues have to be disclosed. See M. De Muynck, 'Consumentenkrediet: Richtlijn 2008/48/EG en de Belgische Uitdaging', *D.C.C.R.*, 2009, n° 2, 38.

²⁹¹ See in this regard: EC Communication, 'Public Consultation on Responsible Lending and Borrowing in the EU', June 2009 stating that pre-contractual information could include '*the various potential (long-term) risks associated with credit, such as the impact of foreign exchange fluctuations, interest variations and changes in asset prices.*'

²⁹² C. I. GARCIA PORRAS and W. H. VAN BOOM, 'Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations', *Rotterdam Institute of Private Law Working Paper*, December 2009, 4.

²⁹³ See article 5 (3) CCD.

²⁹⁴ See C. I. GARCIA PORRAS and W. H. VAN BOOM, 'Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations', *Rotterdam Institute of Private Law Working Paper*, December 2009, 23.



44. **OVERDRAFT FACILITIES' LIGHT REGIME.** Overdraft facilities in many respects enjoy a particular treatment under the CCD.²⁹⁵ Besides the exclusion under its scope of some overdraft facilities²⁹⁶, the CCD unfortunately developed a sort of 'light regime' for the remaining overdrafts under its scope.²⁹⁷ The circumstance that credit cards, revolving credit and credit lines are poorly regulated could strike somewhat as a paradox given several observations made earlier in this contribution. For overdraft facilities that have to be repaid on demand or within three months, Member States may for example decide that creditors don't need to provide borrowers with an APR in the pre-contractual stage.²⁹⁸

Needless to say that such relaxed regime – if transposed by a Member State - leaves the door open for creditors to convert open-end agreements to contracts that are repayable at demand. Financial industries' sighs about the costs of (over)regulating overdraft facilities, indeed leading creditors to refrain from offering this type of credit - consequently jeopardizing consumers' access to credit – clearly made an impression in Brussels.²⁹⁹ We saw that instalment credit is increasingly 'disguised' as an overdraft facility (see nr. 4). A light though regime for overdraft facilities risks to incite creditors even more strongly to promote this form of credit over the classic, more regulated ones.³⁰⁰

45. Article 12 CCD introduces a duty to inform overdraft borrowers on a regularly basis 'by means of a statement of account, on paper, or on another durable medium' besides on increases of the borrowing rate or any charge payable (before they enter into force³⁰¹) on (a) the precise period to which the statement of account relates; (b) the amounts and dates of drawdowns; (c) the balance from the previous statement, and the date thereof; (d) the new balance; (e) the dates and amounts of payments made by the consumer; (f) the borrowing rate applied; (g) any charges that have been applied; (h) where applicable, the minimum amount to be paid. Overdraft facilities are often included in the standard personal account packages that financial institutions offer their clients as an option to overrun the account (see nr. 3). Article 18 CCD provides in this regard a particular information scheme. In the event of a significant overrunning *exceeding a period of one month (!)*, creditors are required to inform borrowers without delay on paper or on another durable medium (a) of the overrunning; (b) of the amount involved; (c) of the borrowing rate; (d) of any penalties, charges or interest on arrears applicable.³⁰²

46. **DISCLOSURE WORKS.**³⁰³ Surveys indicating that disclosure especially improves middle and upper class income consumers' awareness with regard to the cost of credit don't break new

²⁹⁵ P. ROTT, 'Consumer Credit', in H.-W. MICKLITZ, N. REICH and P. ROTT (eds.), *Understanding EU Consumer Law*, Intersentia, Antwerpen, 2009, 208.

²⁹⁶ See article 2 (2) stating that the directive shall not apply 'on credit agreements in the form of an overdraft facility and where the credit has to be repaid within one month' (i.e. credit cards), nor on credit agreements 'where the credit is granted free of interest and without any other charges and credit agreements under the terms of which the credit has to be repaid within three months and only insignificant charges are payable' (see article , 2 (2)f CCD. These forms of credit clearly does not escape complicity of causing a slide into debt from several consumers. It could therefore be regretted that the Directive reasoned in narrow terms about the problem of over indebtedness. Sliding into debt is certainly not bound to such discretionary barriers.

²⁹⁷ See article 2(3) CCD: 'In the case of credit agreements in the form of an overdraft facility and where the credit has to be repaid on demand or within three months, only Articles 1 to 3, Article 4(1), Article 4(2)(a) to (c), Article 4(4), Articles 6 to 9, Article 10(1), Article 10(4), Article 10(5), Articles 12, 15, 17 and 'Articles 19 to 32 shall apply.'

²⁹⁸ See article 6 (2) CCD.

²⁹⁹ See S. M. FRANKEN, 'The Political Economy of the EC Consumer Credit Directive'; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 136.

³⁰⁰ M. WESTPHAL, 'The EU Financial Services Policy and its Effect on Consumer Law', in KELLY-LOUW, NEHF and ROTT (eds.), *The Future of Consumer Credit Regulation. Creative Approaches to Emerging Problems*, Ashgate, Hampshire, 2008, 82.

³⁰¹ Article 12 (2) CCD however provides an exclusion on the obligation to inform overdraft borrowers *before* the rate change with regard to an interest rate determined by a reference rate.

³⁰² Article 18 (3) CCD provides that the information requirements are without prejudice to any rule of national law requiring the creditor to offer another kind of credit product when the duration of the overrunning is significant.

³⁰³ For some people, probably including you, given your diligence to check this footnote. Please continue the reading of this part to discover how disclosure could work (more effective).



ground.³⁰⁴ Disclosure is alleged to have little or no influence on credit decisions from more vulnerable consumers.³⁰⁵ From a redistributive or welfarist viewpoint the desirability of such “reversed asymmetric paternalism” could be questioned. Further research is - without doubt - the obvious means either to take the edge of similar argument, or to confirm such claims. Nonetheless, we already ascertain how information requirements’ *ex ante* fruits could be improved.³⁰⁶

47. NOT ALL PERSONS ARE CAPABLE OF BEING CAREFUL READERS.³⁰⁷ **THE MYTH OF THE “ONE-SIZE FITS ALL APPROACH”.**³⁰⁸ A common critique is that European information requirements tend to prefer the side of the sellers or providers since they allow information to be provided in the seller’s/ provider’s professional wording instead that of the consumer.³⁰⁹ The Consumer Credit Directive indeed all in all little seems to bother whether consumers are able to absorb and understand to prescribed information.³¹⁰ Complex overdraft formulas are often difficult to fathom and struggling through legalese documentation equally posits a problem for many consumers (see nr. 10-11).

Disclosure is not an end itself but is deemed to mitigate market failures as well as individual shortcomings.³¹¹ The omission to enlighten, on a clear and concise way a vast category of borrowers about some of the most essential characteristics of the pursued credit, reveals a schizophrenic side of current information regime. Aimed at remedying informational asymmetries, the European Consumer Credit Information Form for Overdrafts (Annex III of the CCD) fails to dense the informational fog between lay borrowers and creditors. Information requirements’ *raison d’être* also infects the legal disclosures themselves.³¹² Comprehension by the addressee of data disclosed by a creditor, is a constitutional element of information. Comprehension distinguishes mere ‘data’ from information.³¹³ Consumer protection’s merits should exceed *formal* transparency; a *substantial* information equilibrium is what matters. To reach this (ultimate) policy goal, financial apathy (whether rational³¹⁴ or irrational) mustn’t be disregarded.

48. WAVING (OLD) PARADIGMS GOODBYE. A PLEA FOR REVISED, TARGETED DISCLOSURE SCHEMES. Having argued that ‘one-size fits all regulation’ fails to deliver a generalized informational equilibrium as emphasized in EC Strategies, we proceed this part with a plea for creativity,

³⁰⁴ W. WHITFORD, ‘The Functions of Disclosure Regulation in Consumer Transactions’, *Wis. L. Rev.*, 1973, 407.

³⁰⁵ See G. HOWELLS and T. WILHELMSSON, ‘EC Consumer Law: Has it Come of Age’, *ELRev*, Vol. 4, 380.

³⁰⁶ Some borrowers will yet benefit *ex post* from disclosure regulations since alleged violation of formal information requirements could be used *ex post* (e.g. after default) as ‘litigation tool’ against creditors. See L. E. WILLIS, ‘Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending’ (June 2005), *Md. L. Rev.*, Vol. 65, 712. Available at SSRN: <http://ssrn.com/abstract=748286> or doi:10.2139/ssrn.748286. Belgian scholars increasingly criticise the excessive formalism of the Consumer Credit Law, that opens the door for abuse by consumers, successfully claiming without prove of real harm.

³⁰⁷ See ‘Judge POSNER’ in *Emery v. American Gen. Fin.*, 71 F. 3d 1343 (7th Cir. III, 1995)

³⁰⁸ C. I. GARCIA PORRAS and W. H. VAN BOOM, ‘Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations’, *Rotterdam Institute of Private Law Working Paper*, December 2009, 29.

³⁰⁹ M. WESTPHAL, ‘The EU Financial Services Policy and its Effect on Consumer Law’, in KELLY-LOUW, NEHF and ROTT (eds.), *The Future of Consumer Credit Regulation. Creative Approaches to Emerging Problems*, Ashgate, Hampshire, 2008,79.

³¹⁰ Mifid specifies in this regard for example that investor information should be sufficient for, and presented in a way that is likely to be understood by, the ‘average member of the group to whom it is directed, or by whom it is likely to be received’. See article 27 (2) Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *O.J. L. 2* September 2006, 241/26..

³¹¹ O. BAR-GILL, ‘Informing Consumers About Themselves’, *Law & Economics Research Paper Series Working Paper N° 07.-44*, 4.

³¹² L. E. WILLIS, ‘Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending’ (June 2005), *Md. L. Rev.*, Vol. 65, 751. Available at SSRN: <http://ssrn.com/abstract=748286> or doi:10.2139/ssrn.748286

³¹³ An ‘information overload’, for example could erode the information addressee’s comprehension and therefore reduce the disclosed ‘information’ to mere data (a phenomenon designated as ‘disinformation’). See J. BING, ‘Information Law?’, *Journal of Media Law and Practice*, 1981, 219.

³¹⁴ Some borrowers indeed reason that the cost to adequately inform themselves (‘time is money’) is likely to outweigh the benefits of such exercise. This reflex, i.e. signing an agreement without reading, is often referred to as rational apathy. See LUTH, H. A., ‘Extending the scope of the Unfair Terms discipline in consumer contracts- an economic and behavioural perspective’, *Rotterdam Institute of Law and Economics Working Paper Series*, No 2008/01, 6.



abandoning conservative policy trails. It is our firm belief that targeted regulation is a more apt means to tackle discussed market distortions, biases and financial illiteracy.

The introduction of a *multi-dimensional* or *multi-layer protection regime*, already known in the field of investment services, could prove beneficial for consumer credit.³¹⁵ Compliance with information requirements lays a heavy burden on the financial industry (see for example footnote nr. 281). A multi-dimensional regime, allowing the introduction of asymmetric paternalism in the field of consumer finance, could trigger a more advantageous employment of both policies' and industries' resources. MIFID already requires investment firms to obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field regarding the product or service the consumer wishes to purchase, his financial background and the client's investment objectives.³¹⁶

One could see no reason why similar layered disclosure couldn't be imported in the field of consumer finance. Both investment services and consumer credit regulations are ought to remedy information asymmetries involving financial 'belief goods'. Especially given multiple bank models largely based on cross-selling in order to induce financial conservatism a strict regulatory dichotomy between a consumer's *assets* and *debts* looks superseded.

49. While society's most vulnerable consumers are likely to benefit from more plain and concise information and would welcome for example the use of pictorial information³¹⁷, other more sophisticated credit users could be better off with individualized light touch disclosure. The introduction of consumer profiles (or ID's) in the field of consumer finance and moreover a generalized use of both the 'know your customer' and 'suitability' rule may, besides an advanced level of consumer protection, generate economies of scale in the financial sector.³¹⁸ Creditors should be induced to develop a "tailored information relationship" with each client, backed by increased IT(C) -possibilities.³¹⁹ Experiments indicate that individualized disclosure, is more effective to alter consumers' behaviour than providing consumers general information about the credit they wish to purchase.³²⁰

Traces of a "know your customer" based information philosophy in the field of consumer credit, could be read in the obligation for creditors and credit intermediaries under Belgian Law for to determine the type of credit, among those types they typically offer, that appears to be best suited to a borrower's specific needs at the time the credit agreement is concluded.³²¹

50. A multi-layer protection regime includes besides *subjective* diversification also a multi-layered substance and a *chronological* spread of information distributed by creditors. As to

³¹⁵MIFID for example makes a distinction between three categories of clients : the retail client, the professional client and the eligible counterparty. See R. STEENNOT, 'Protecting investors through Information Requirements, in S.M. KIERKEGAARD (Ed.), *Private Law, Rights, Duties & Conflicts*, 2010, 572-588.

³¹⁶ Article 19 (4) Investment Services Directive (ISD) 2004/39/EC: 'When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potent client investment services and financial services that are suitable for him.' If you would replace the term 'investment' by credit, this requirement could be fit in any credit legislation.

³¹⁷ See 'Warning: Too much information can harm. A final report by the Better Regulation Executive and National Consumer Council on maximizing the positive impact of regulated information for consumers and markets.', Better Regulation Executive and National Consumer Council, November 2007, 13

³¹⁸ Merging information rules for consumer finance and investment services may generate economies for large financial institutions that support their business model on cross-selling of both investment as credit products, e.g. with regard to IT-applications, staff specialisation, compliance rules, etc.

³¹⁹ One should however ascertain the existence of (hidden) costs, privacy concerns, etc. It is therefore important to proceed with caution.

³²⁰ See for example S. BLOCK- LIEB, R. WIENER, J. A CANTONE and M. HOLTJE, 'Disclosure as an Imperfect Means for Addressing Overindebtedness: An Empirical Assessment of Comparative Approaches', in ' ; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 168. The

³²¹ See current article 11, 2° Belgian Consumer Credit Code (from 1 December 2010 this obligation is incorporated in article 15 Belgian Consumer Credit Code).



the substance, policy must breach product disclosure prevalence and address borrowers use-patterns.³²² Credit laws should shift their focus from *contract* regulation towards *product* regulation. If consensus is reached that particular types of credit - at least for some borrowers - could be qualified as “harm causing debt products” credit legislation ought to be aligned with product legislation, as for example the case in the pharmaceutical sector, where manufactures are required to disclose information regarding health risks and (optimal) product use (see nr. 37).³²³ As to the chronological pillar, regulations’ disproportional attention to *pre-contractual* disclosure, despite behavioural insights and evidence about the shopping pattern of average financial consumers was already stressed. It is striking that *post-contractual* information requirements were largely left out of the Directive’s scope. On the other hand, this paves the road for national policy, altered to country specific realities. In this regard, we will argue below that post- contractual *Wealth warnings* are likely to be convenient means to mitigate financial distress (see nr. 55). Shifting away from information-egalitarianism indeed equally implies re-balancing the heart of information requirements to post-contractual disclosure both for particular types of credit as for particular types of borrowers (giving evidence of a use-pattern that requires (tailored) post-contractual disclosure).

51. *ENABLING “APPLES-TO-APPLES” COMPARISONS.*³²⁴ *A PLEA FOR A SINGLE APR DISCLOSURE IN ADVERTISING.* Conceived as a means to mitigate adverse effects suffered by borrowers due to an information overload, APR-disclosure did certainly not succeed in living up its great promise.³²⁵ Given consumers’ alleged sensitivity to the cost of credit,³²⁶ APR-disclosure in advertising (chronologically the first pillar of a multi-layered information scheme) is said to stimulate shopping for credit. Enhanced shopping, fostering competition among different creditors, should lead to cheaper credit. Some disclosure advocates claim that the APR as major shopping *yardstick*, even benefits borrowers who are unable to fully understand the advertised terms.³²⁷ After all, even consumers without a degree as nutritionist benefit from calorie disclosure if they are aware that they should look for the smallest number of calories. In a *multi-level protection regime* a first layer of protection could indeed exist of single APR-disclosure as a powerful antidote for imperfect rationality.³²⁸

An APR as unitary pricing vehicle in advertisements is expected to benefit from consumers’ simplifying heuristics (see nr. 19) and moreover to remedy consumers’ wrongful focus on monthly payments.³²⁹ The CCD seems – for contracts within its scope - to leave Member States the option to introduce single APR-disclosure in credit advertising.³³⁰ Single-APR disclosure in advertisement fits in a multi-layered information philosophy since it offers an *anchor*, reducing search-cost for a vast amount of borrowers unable to master complex credit information, without adverse effects for more sophisticated consumers that remain free

³²² O. BAR-GILL, ‘Informing Consumers About Themselves’, *Law & Economics Research Paper Series Working Paper N° 07.-44*, 4.

³²³ O. BAR-GILL, ‘Informing Consumers About Themselves’, *Law & Economics Research Paper Series Working Paper N° 07.-44*, 48.

³²⁴ E. RENUART, D. E. THOMPSON, ‘The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise Of Truth in Lending’, *Yale J. on Reg.*, Vol. 25, at nr. 222.

³²⁵ O. BAR-GILL, ‘The Law, Economics and Psychology of Subprime Mortgage Contracts,

³²⁶ W. WHITFORD, ‘The Functions of Disclosure Regulation in Consumer Transactions’, *Wis. L. Rev.*, 1973, 406.

³²⁷ E. RENUART, D. E. THOMPSON, ‘The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise Of Truth in Lending’, *Yale J. on Reg.*, Vol. 25, at nr. 211. Regrettable is that the requirement to provide the information in a particular order didn’t survive the European Parliament. Such obligation would benefit comparison between different advertising. See P. ROTT, ‘Consumer Credit’ in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 192.

³²⁸ O. BAR-GILL, ‘The Law, Economics and Psychology of Subprime Mortgage Contracts, *Cornell. L. Rev.*, Vol. 94

³²⁹ L. E. WILLIS, ‘Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending’ (June 2005), *Md. L. Rev.*, Vol. 65, 744. Available at SSRN: <http://ssrn.com/abstract=748286> or doi:10.2139/ssrn.748286

³³⁰ See article 4(1) CCD: ‘Standard information to be included in advertising (article 4) Any advertising concerning credit agreements which indicates an interest rate or any figures relating to the cost of the credit to the consumer shall include standard information in accordance with this Article. This obligation shall not apply where national legislation requires the indication of the annual percentage rate of charge in advertising concerning credit agreements which does not indicate an interest rate or any figures relating to any cost of credit to the consumer within the meaning of the first subparagraph.’



to require additional information from a creditor in the consecutive pre-contractual stage (i.e. chronological spread of information). Market-discipline is expected to be strengthened by single-APR disclosure. Anchoring on APR, may also be a factor contributing to increased consumer mobility to the detriment of financial conservatism.³³¹

52. The APR yet only is an adequate *anchor* in an all-inclusive unitary pricing system.³³² Creditors shouldn't be allowed to abuse complexity through *multidimensional price structures*, i.e. by selling additional – separately priced- products or services (e.g. a credit insurance) to borrowers when applying for credit. While competing on APR, multidimensional pricing opens the door to recover a lower APR margin by charging a non-competitive price for an ancillary product or service.³³³ Complex pricing is also said to steer consumers' choice of creditor to other characteristics (e.g. reputation, location,..) to the detriment of the cost of credit.³³⁴ Legislation should therefore safeguard the APR as a “*one-dimensional cost indicator*”.³³⁵

In accordance with the financial industry's sighs, the voluntary insurance was excluded from the total cost of credit.³³⁶ This may incite creditors to disguise the insurance as a voluntary ancillary service while putting commercial pressure on consumers to opt for this 'voluntary' service in order to be eligible for credit. Notwithstanding a formal prohibition in the Belgian Consumer Credit Code to oblige a borrower to subscribe on an insurance offered by the creditor or a by him designated third party,³³⁷ jurisprudential examples of creditors (morally) forcing a borrower to take an insurance are thick.

53. **PERSONALISED INFORMATION. DISCLOSURE'S MIRROR FUNCTION.** While arguing the necessity of a tailored information relationship within a broader multi-layer protection regime, we ascertained that means of communication apt to reach over-indebted consumers might differ from those appropriate for other borrowers.³³⁸ Different use-patterns call for different disclosure.³³⁹ Before touching upon advanced monthly statement disclosure as a transition to debit rate disclosures required by the Belgian Law of 14 July 1998 (B.), we briefly outline how tailored point of sale disclosure could contribute to the prevention of “a slide in to debt” *in the course of an existing credit (card) relation*.

54. **POINT OF SALE DISCLOSURE. THINK TWICE BEFORE PUSHING THE OK BUTTON.** In part I, we observed several factors of /conducting to financial behaviour deviating from perfect

³³¹ Since a reduction of search costs may induce a consumer to shop around in course of the existing credit agreement. In order to stimulate this reflex, it is equally required that post-contractual documentation discloses APR on a salient way.

³³² E. RENUART, D. E. THOMPSON, 'The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise Of Truth in Lending', *Yale J. on Reg.*, Vol. 25, at nr. 207. For credit agreements within its scope, the Consumer Credit Directive aims to prevent such unbundling what could enhance competition in the markets for consumer finance. Article 19 prescribes how the annual percentage rate has to be calculated, stipulating for example that 'The costs of maintaining an account recording both payment transactions and drawdowns, the costs of using a means of payment for both payment transactions and drawdowns, and other costs relating to payment transactions shall be included in the total cost of credit to the consumer unless the opening of the account is optional and the costs of the account have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer.' With regard to overdraft facilities linked to a current account one must not only focus on the **direct price**, this is what a consumer must to pay for using the overdraft facility, but also on **indirect price aspects**, e.g. the fact that a current account with overdraft facilities yields low returns (i.e. a loss of potential gains).

³³³ See S. M. FRANKEN, 'The Political Economy of the EC Consumer Credit Directive'; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 133.

³³⁴ See S. M. FRANKEN, 'The Political Economy of the EC Consumer Credit Directive'; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 142.

³³⁵ O. BAR-GILL, 'Informing Consumers About Themselves', *Law & Economics Research Paper Series Working Paper N° 07.-44*, 12.

³³⁶ See S. M. FRANKEN, 'The Political Economy of the EC Consumer Credit Directive'; in J. NIEMI, I. RAMSAY and W. C. WHITFORD (eds.), *Consumer credit, debt and bankruptcy. : comparative and international perspectives*, Oxford, Hart, 2009, 138.

³³⁷ See article 31 Belgian Consumer Credit Code.

³³⁸ For early traces of such measure of asymmetric paternalism See W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.*, 1973, 440.

³³⁹ C. I. GARCIA PORRAS and W. H. VAN BOOM, 'Information disclosure in the EU Consumer Credit Directive: Opportunities and limitations', *Rotterdam Institute of Private Law Working Paper*, December 2009, 16.



rationality that are susceptible to mitigation by enhanced – tailored - disclosure at the point of sale. Without being exhaustive, reference could be made to consumers troubled with mental unbundling of both the transaction and credit function of a single card (see nr. 5), difficulties of recollecting past transactions and underestimation of the funds already borrowed in the course of a given period (see nr. 32), cumulative cost neglect (see nr. 25), etc. Virtual currency apparently scales down perceptions about budget scarcity. We noticed that consumers' failure to check their balance on a regular basis largely contributes to (unauthorized) overdrafts (see nr. 22). All these factors question the classic belief that consumers have an informational advantage with regard to their own (credit) use-pattern (see nr. 8). Whereas the CCD's information requirements (both pre-contractual and contractual) are mainly construed to remedy information- asymmetries *regarding the complex product characteristics of credit*, point of sale disclosure might be a proper means to mitigate consumer errors about *consumers' own financial conduct*.³⁴⁰

Notwithstanding little consumers will be opposed to receive additional information about their current spending pattern, an opting-out system could be considered here (targeted-paternalism). So-far a first layer of information. If a particular spending pattern yet *causes* or *risks to cause* (unauthorized) overdraft use, an appeal on a extra layer of disclosure may be required. In the latter case, point of sale disclosure could enhance consumers' awareness by warning them about the ultimate cost of the transaction they wish to pursue. Such ultimate cost includes the cost credit. Apart from tackling mere unawareness, a similar wealth warning attempts to mitigate hyperbolic discounting biases. It may induce consumers to include the options of (1) paying cash or (2) to refrain from a transaction in their decision-making.³⁴¹

All in all such (digital) mirror accomplishes a more substantial information equilibrium. Such (light touch) disclosure – if effective - is to be preferred to a more stringent legal intervention (e.g. opt-in/ opt-out when concluding the agreement³⁴²). Despite the financial sector's prompt use of emerging IT-developments, e.g. offering credit by text message, one could speak of a reticence to apply these digital developments to enhance consumer protection, e.g. by employing payment terminals for wealth-warnings. Such warning could look like this:

“Dear Sir/ Madam. The funds on your current account are insufficient to cover the cost of this transaction. If you wish to pursue your buying, be aware that besides a charge of x EUR, an interest rate of x percent will be due. Please press 1) CANCEL if you wish to refrain from transaction or 2) OK if you wish to continue”

55. (MONTHLY) STATEMENTS. FIXING THE FRAME. An unappealing format discourages consumers to absorb information disclosed on creditors' (monthly) statements.³⁴³ Credit Legislation might therefore require creditors to *frame* or *re-frame* the information on such statements (see nr. 45 on the information requirements included in article 12 and 18 CCD). Both *content* as *format* (e.g. a particular order of the disclosed information) should be subject to a legal frame able to mitigate some of the most harmful biases and heuristics. Legal framing may imply an *obligation* to disclose particular information as well as a *prohibition* of certain disclosures (see nr. 28 regarding publicity on the monthly statements to induce to consumers to take up credit) If further experiments - for example - verify evidence suggesting that most borrowers only pay attention at no more than three categories of information when reading their monthly

³⁴⁰ O. BAR-GILL, 'Seduction by Plastic', 98 *Nw. U. L. REV.* 1373.

³⁴¹ W. WHITFORD, 'The Functions of Disclosure Regulation in Consumer Transactions', *Wis. L. Rev.*, 1973, 407.

³⁴² See in this regard Regulation E in the United-States.

³⁴³ See 'Warning: Too much information can harm. A final report by the Better Regulation Executive and National Consumer Council on maximizing the positive impact of regulated information for consumers and markets.', Better Regulation Executive and National Consumer Council, November 2007, 7.



statements³⁴⁴, legislators may require creditors to communicate some information – for example adverse change warnings, or the consequence of only making minimum payments (see number 56), etc. *separately* from the monthly statements (e.g. in writing, by (ordinary) mail, text message or at least in a separate format (colour, type font and/size),³⁴⁵ to prevent too much distraction by other information.³⁴⁶ Compliance costs of (re) framing seem moderate,³⁴⁷ given the fact that the information is already in creditors' possession and the additional costs limit themselves to the cost of communicating such information.³⁴⁸ While such measures may lead to better communication with less attentive consumers, other – more - rational are barely hindered.

Advanced regulation may moreover target the requirement to (re-) frame to clearly defined groups of consumers (“know your customer”).³⁴⁹ Whereas in some Member States today distribution of monthly statements to every debtor or current account holder is required, a multi-layer information regime may liberalize such obligation for more sophisticated financial consumers (e.g. allowing *this category* of consumers to opt-out and to switch to a more ‘execution only’ credit relationship³⁵⁰).

56. Monthly statements or, more in general, individualized information (e.g. wealth-warning by ordinary mail or text message) may prevent that the most dangerous terms of credit agreement are only brought to the borrower's attention when it's already too late (see nr. 22). Whereas it conditions disclosure requirements in case of overrunning to an elapse of a month, article 18 CCD fails to intervene timely. Individualised information mitigates selective ignorance.³⁵¹ Individualized statements *could* contain a minimum payments warning³⁵² for example:

“Dear Sir/ Madam. You are currently repaying the minimum amount. At the current APR, it will take you x-months to repay your outstanding debt. Be aware that cheaper finance mechanisms are available. For personal credit advice please call the [toll-free] number xxxxxxxxxxxxxxxxx.”

A similar light though regulation is - again at least initially – preferred over the introduction generalized minimum payment requirements by law. Such non-targeted legal requirement risks - besides adversely affecting some sophisticated consumers that have a rational financial incentive to limit their repayments – to jeopardize numerous consumers that wouldn't be able to keep pace with a blanked increase of their current payment scheme.³⁵³ Individualized communication could furthermore disclose average credit rates on the market and

³⁴⁴ E. RENUART, D. E. THOMPSON, ‘The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise Of Truth in Lending’, *Yale J. on Reg.*, Vol. 25, at nr. 243.

³⁴⁵ See BIS, ‘A Better Deal for Consumers. Review of the Regulation of Credit and Store Cards: Government Response to Consultation.’, March 2010, 38

³⁴⁶ W. WHITFORD, ‘The Functions of Disclosure Regulation in Consumer Transactions’, *Wis. L. Rev.*, 1973, 467.

³⁴⁷ Such cost could be designated as a one-time implementation operating cost. See . ELLIEHAUSEN, ‘The Cost of Bank Regulation: A Review of the Evidence’, *Board of Governors of the Federal Reserve System*, N° 171, April 1998, 3. Besides an impact assessment, further studies, calculating the exact costs of the proposed measure are however recommended, among other things investigate eventual hidden costs.

³⁴⁸ O. BAR-GILL, ‘Informing Consumers About Themselves’, *Law & Economics Research Paper Series Working Paper* N° 07.-44, 63.

³⁴⁹ See for example also Directive 2005/29/EC (Unfair Commercial Practices) that specifies that provides that the average person should be determined as the average member of the group at which the practice is directed.

³⁵⁰ Mifid for example leaves the door open for investors to ask their institution to be treated as a professional client (i.e. an upgrade, reducing the information requirements). If certain conditions are met, the investment firm could allow such light regime to be applicable on the investor, hereby enlarging the client's choice of investment products. See R. STEENNOT, ‘Protecting investors through Information Requirements’, in S.M. KIERKEGAARD (Ed.), *Private Law, Rights, Duties & Conflicts*, 2010, 572-588.

³⁵¹ E. RENUART, D. E. THOMPSON, ‘The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise Of Truth in Lending’, *Yale J. on Reg.*, Vol. 25, at nr. 210.

³⁵² ‘Warnings’ should be distinguished from mere ‘information’, given their explicit intention to bring to the addressee's notice certain dangers, risks or uncertainties, both from a legal as material nature. See A. DE BOECK, *Informatierechten en -plichten bij de totstandkoming en uitvoering van overeenkomsten : grondslagen, draagwijdte en sancties*, Antwerpen, Intersentia, 2000, 78.

³⁵³ BIS, ‘A Better Deal for Consumers. Review of the Regulation of Credit and Store Cards: Government Response to Consultation.’, March 2010, 23.



commitment devices offered by a creditor e.g. automated transfers, the option to reduce one's credit limit, etc enabling some categories of consumers to reduce the reality-gap between intentions and actual behaviour. Finally, *annual statements* should allow easy comparison with other creditors (their APR – see nr. 51).³⁵⁴

B. Belgian Law of 14 July 1998³⁵⁵

57. The Belgian Legislator deemed it necessary to call into being an additional informational regime regarding the costs of overrunning a current account, to the informational regime for overdraft facilities that fall within the scope of the Belgian Consumer Credit Law. The law of 14 July 1998 aims to protect *consumers* by requiring the disclosure of the debit rate on *every monthly statement*, and this as long as a current account shows a negative balance.³⁵⁶ It specifies that the debit rate has to be disclosed as a percentage on *annual* basis, given the frequent practice to express the costs of overrunning as a percentage on *daily* basis.³⁵⁷ The law is equally applicable on non-financial institutions ("*legal entities offering current accounts in Belgium*"³⁵⁸). The preliminary report especially mentions super markets in this regard.³⁵⁹ Finally, it introduces a sanction for the non respect of its information requirements: as long as the creditor fails to disclose the debit rate on the monthly statement, he is not allowed to charge the consumer for the overrunning. Notwithstanding its good intentions, one could question the efficiency of this Law. It (1) strongly overestimates consumers diligence to collect their monthly statements, (2) fails to introduce a frame for the information as well as (3) an explanation or an example with regard to the debit rate that will be charged, (4) as well as to ensure compliance whereas the Law's sanction is entrusted to enforcement by consumers that are deemed to be informed of the aforementioned rights.

III. THE UNFAIR TERMS DIRECTIVE'S DEAD ANGLE: "CORE EXCLUSIONS", (UNREGULATED) OVERDRAFT CHARGES AND PLAIN AND INTELLIGIBLE LANGUAGE

*"In the ordinary way the customer has no time to read standard contract terms, and if he did read them he would probably not understand them and if he did understand and object, he would generally be told he could take it or leave it. And if he then went to another supplier the result would be the same."*³⁶⁰

58. *INTRODUCTION.* Most (retail) bank contracts are pre-formulated documents imposed - without any form of negotiation - on consumers seeking financial services.³⁶¹ Agreements with regard to overdraft facilities are no exception and often equally offered under the aforementioned "take it or leave it" formula. Numerous legal instruments aim to counteract potential adverse effects of such *de facto* monopoly over the contract terms. After having explored both pre-contractual and post-contractual disclosure as a tool to protect overdraft

³⁵⁴ BIS, 'A Better Deal for Consumers. Review of the Regulation of Credit and Store Cards: Government Response to Consultation.', March 2010, 44.

³⁵⁵ De Wet van 14 Juli 1998 Houdende de verplichting om informatie te verstrekken over de debetrente op bij kredietinstellingen of andere rechtspersonen geopende rekeningen (or 'Loi du 14 juillet 1998 portant obligation d'information quant aux intérêts débiteurs dus sur les comptes ouverts auprès des établissements de crédit ou d'autres personnes morales), Published in the Belgian State Gazette of September 18 1998. Hereafter referred to as 'Law of 1998'. In the December 2010, this law will be abolished given the expanded scope of the renewed Consumer Credit Code, containing a similar mechanism.

³⁵⁶ See article 2 law of 1998.

³⁵⁷ See P. LETTANY, 'De Wet van 14 Juli 1998 Houdende de verplichting om informatie te verstrekken over de debetrente op bij kredietinstellingen of andere rechtspersonen geopende rekeningen', Artikelsgewijze commentaar financieel recht, Afl. 15.

³⁵⁸ Article 2 law of 1998.

³⁵⁹ See Parl. St. Kamer gewone sitting 1997-98, 1317/5, Verslag SCHOETERS, namens de Commissie voor de Financiën en de Begroting, page 2 and 4.

³⁶⁰ Suisse-Atlantique case House of Lords [1967] 1 AC 361.

³⁶¹ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 122.



borrowers, we now have a look at a means of *substantive* consumer protection. With the birth of the Unfair Terms Directive, an ambitious Community instrument saw the light.³⁶² For the first time, European consumer policy extended its focus to substantive regulation affecting the content of the contract, offering an *ex post* cushion of consumer protection.³⁶³ Article 3 of the directive provides that a contractual term which has (1) not been individually negotiated shall be regarded as unfair if, (2) contrary to the requirement of good faith, it (3) causes a significant imbalance in the parties' rights and obligations arising under the contract, (4) to the detriment of the consumer.³⁶⁴ When assessing the *objective* scope of application of the Unfair Terms Directive, three major limitations on its application could be unveiled.

59. A first requirement is *the absence of an individual negotiation* between the parties. Terms that were not imposed on the consumer but result from an individual bargain are therefore excluded from assessment.³⁶⁵ *Contract terms which reflect mandatory statutory or regulatory provisions*, are equally ruled out from the scrutiny of a fairness control.³⁶⁶ Given that such terms are for the most part a legislative manner to introduce equitable solutions into the contract, a rather obvious exclusion.³⁶⁷ Finally, article 4(2) of the Directive stipulates that "*the assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language*". This so-called "core exclusion", that slipped through a backdoor into Directive 93/13/EEC when it was adopted on April 5 1993³⁶⁸, prevents courts

³⁶² Council Directive 93/13/EEC relating to the approximation of the laws and administrative provisions of the Member States concerning unfair terms in consumer contracts, OJ L 95, 21 April 1993, 29. (Hereafter referred to as 'Unfair Terms Directive')

³⁶³ S. WEATHERHILL, 'An ever tighter grip: the European court's pro-consumer interpretation of the EC's directives affecting contract law', in A. M. RABELLO (ed.), *Essays on European Law and Israel*, Harry and Michael Sacher Inst. for Legislative Research and Comparative Law, Jerusalem, 1046.

³⁶⁴ T. PFEIFFER, 'Non Negotiated Terms', in R. SCHULZE (ed.), *CFR and Existing EC Contract Law*, 2nd Edition, 185.

³⁶⁵ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 115. Without discussing this condition, it should be noticed that some Member States, e.g. Belgium and the Nordic countries, didn't transpose this provision in their national legislation, therefore making use of the option foreseen by the Directive's preamble and the minimum harmonisation character.

³⁶⁶ Article 1(2) Unfair Terms Directive.

³⁶⁷ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 115.

³⁶⁸ As not rarely the case with attempts to introduce new EU-legislation, the birth of Directive 93/13/EC was preceded by what proved to be a difficult pregnancy. The decision of the European Lawmakers to harmonize European contract law dates back from September 1984, when the European Commission launched its first proposal for a Directive regarding Unfair Terms (OJ C 243, 28 September 1990, 2.). The option for a Directive had been left open in a Green Paper regarding consumer policy published in 1984 (COM (1984) 55, 9 February 1984). Most of the Member States introduced unfair contract terms legislation in the seventies and the eighties (For an overview: see HONDIUS, 'The Reception of the Directive on Unfair Terms in Consumer Contracts by Member States', *ERPL* (European Review of Private Law) 1995, Vol. 3, 241-242.) The road to a European consensus seemed to be paved with a fair amount of obstacles that had to be overcome. Internal negotiations in the Commission revealed conflicts on a legal basis, competence and not unimportant: the scope and intensity of the future Directive (H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 123.) A critical assessment of both the European Parliament and the Economic and Social Committee, lead to a number of amendments and the presentation of a new proposal by the European Commission in March 1992. This 'second proposal' (COM (1992) 66 OJ C 73, 24 March 1992, 7.), neither as its predecessor, contained a trace of a *restriction* of its scope regarding the assessment of the price and main subject matter of the contract, nor did it gave any indication about an *inclusion* of price and main subject matter in the assessment of fairness. Commentators criticised this obscurity (See for example: BROWNSWORD, HOWELLS and WILHELMSSON, 'The EC Unfair Contract Terms Directive and Welfarism', in BROWNSWORD, HOWELLS and WILHELMSSON (eds.), *Welfarism in Contract Law*, Aldershot, Dartmouth, 1994, 275.) Some argued that the proposal aimed a comprehensive control of the contractual terms whereas others on the contrary were convinced that the use of the notion 'term' or 'contractual term' referred exclusively to those terms other than the price or the main subject of the contract (so-called 'collateral terms') (see BRANDNER and ULMER, 'The Community Directive on Unfair Terms in Consumer contracts: some critical remarks on the proposal submitted by the EC Commission', *CML Rev.* 1991, 655.) As finding a consensus in the Commission already proved to be a heavy cross, this was all the more the case in the European Council. There protection level offered by the Member States largely differed (see BERNITZ, 'Swedish Standard Contracts Law and the EEC Directive on Contract Terms', in LANBOY, *Enhancing the legal position of the European Consumer*, European Law Series, British Institute of International and Comparative Law, London, 1996, 189.) While deliberating on the proposal of horizontal harmonization of contract law on European level, the Member States struggled on the exact scope of the future Directive. In order to reach a compromise, the Council agreed to reduce both the scope as protection level of the proposed directive (H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 125.) The Common Position of the Council, reflecting a compromise between the French and the German model³⁶⁸, also lead to the above mentioned restriction in article 4(2) of the Directive and thus the exclusion of price and main subject matter from assessment, notwithstanding both Proposals made no reference to such an exclusion (see H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 204. and Council Document 8406 January 1992, JCP 1992, 469.) The European Council seemed anxious that a submission of this last bastion of freedom of contract to the Directive would antagonize some Member States and consequently jeopardizing a 'European



from setting aside prices -even when they are excessively unfair.³⁶⁹ Given their central character in the contract, terms that symbolize the *quid pro quo* of an agreement, are presumed to be subject of (thorough) consideration by a consumer. In a free market economy, it belongs to the parties and not a legislator, nor a judge, to shape or reshape the principal obligations of an agreement. Contracts are not required to be fair in an economic sense but clear.³⁷⁰ Market discipline and competition are alleged to safeguard consumers against onerous core terms.³⁷¹

60. In a number of Member States the review of unfair terms equally encompasses the subject matter of the contract and the adequacy of the price.³⁷² Directive 93/13/EC is deemed to be integrated, as one of the directives of the consumer acquis that are currently under review, in the proposed Directive on Consumer Rights prepared by the European Commission. However this Proposal includes important and substantive changes in the field of contract law, it continues to exclude core terms from its scope.³⁷³ Given the Proposal's full (targeted) harmonisation character³⁷⁴, the preservation of this exception could be seen as a decline of the protection level of the European consumer. The proposed Directive seems therefore to set out both a minimum and a maximum level of harmonisation: Member States are not allowed to do more, nor to do less.³⁷⁵ It is questionable whether maximum harmonisation of the law regarding unfair terms in its present state is desirable given the risk of a reduction of the level of consumer protection in some Member States.³⁷⁶

61. In our first part, consumers' ability to grasp the real costs of overdraft facilities, as well as the aforementioned competition argument were severely questioned. After having discussed both pre-contractual and post-contractual protection mechanisms, this part outlines the *ex post* assessment of fairness through judicial control with regard to overdraft charges. As Belgian financial institutions' business model with regard to current accounts significantly differs with the 'free if in credit' regime in the U.K., demarcating the core terms with regard to current accounts proves a lesser challenge. An *annual management fee* covers (within a certain limit) different services offered to current account holders. These include the collection and payment of cheques, money transmission services, cash distribution, monthly statements, etc. *Authorized* as well as *unauthorized* overdrafts are subject to debit interest. Both the Belgian Consumer Credit Code and the Law of 14 May 2001 prohibit financial institutions to impose supplementary charges up to this –legally capped - debit rate (see Part IV). This legal intervention with regard to overdraft charges implicates – besides a greater ease to demarcate which price terms are to be considered as core terms – equally that overdraft facilities within

consensus'. This lead to a 'middle-of-the road approach'; the character of minimum harmonization left more ambitious Member States the option to introduce more protecting, consumer friendly legislation. It should therefore be clear that The recent controversy regarding non-negotiated terms and unfairness in the light of the Draft Common Frame of Reference confirms this issue to be far more significant than many other parts of contract law. (see T. PFEIFFER, 'Non Negotiated Terms', in SCHULZE, R. (ed.), *CFR and Existing EC Contract Law*, 2nd Edition, 183.)

³⁶⁹ O. LANDO, 'Liberal, social, and 'ethical' justice in European contract law', *CML Rev.* 2006, 827.

³⁷⁰ See H. COLLINS, 'Good Faith in European Contract Law', *OJLS* (Oxford Journal of Legal Studies), 1994, 229.

³⁷¹ See for example Opinion of advocate General V. Trstenjak from October 29, 2009 in Case C-484/08 ECJ, *Caja de Ahorros y Monte de Piedad de Madrid v. Asociación de Usuarios de Servicios Bancarios (Ausbanc)*

³⁷² H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 200.

³⁷³ J. STUYCK, 'Unfair Terms', in HOWELLS and SCHULZE (eds.), *Modernising and Harmonising Consumer Contract Law*, Sellier, Munich, 2009, 115.

³⁷⁴ See article 4 of the Proposal: 'Member States may not maintain or introduce in their national law, provisions diverging from those laid down in this Directive, **including more or less stringent provisions**, to ensure a different level of consumer protection.'

³⁷⁵ J. STUYCK, 'Unfair Terms', in Howells and Schulze (eds.), *Modernising and Harmonising Consumer Contract Law*, Sellier, Munich, 2009, 137.

³⁷⁶ H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 203.

the law's scope are excluded from content review under the *Directive's* fairness-test.³⁷⁷

Since mandatory or regulatory provisions are presumed to be fair³⁷⁸, the Directive recognises the prerogative of Member States' contract law.³⁷⁹ The Belgian Legislator yet didn't (explicitly) transpose this exclusion in *the Belgian Law from 14 June 1991 regarding Trade practices, information and Consumer Protection*.³⁸⁰ Nonetheless, it seems safe to assume that the Courts won't challenge an interest rate below the legal cap as being an unfair term. One might look at it as a unwritten principle.³⁸¹

62. In what follows we briefly focus on the plain and intelligible language requirement included in both article 4 (2) and article 5 of the Unfair Terms Directive. Our assumption that consumer regulation might have to descend a step further on the ladder of (ir)rationality by incorporating imperfect borrowers' knowledge about own – sometimes biased – behaviour (see Part I C) – besides technical and legal information about a particular type of credit-, also affects contractual information. Article 10 CCD prescribes which information has to be included in the credit agreement but fails to address the wording used to disclose such information. There is no reason for a strict dichotomy between pre-contractual and contractual disclosure. Both aim at the accomplishment of a *de facto* information equilibrium between borrowers and creditors and may therefore be seen as distinct elements of a single but multi-layered information regime (see nr. 48). Transparency should enable a borrower to decide *with full knowledge of the content of the contract* whether or not to conclude an agreement.³⁸² Transparency has consequently to be established *before* the agreement for an overdraft facility is concluded³⁸³ by making the contract terms available to the consumer in a manner which gives him *a real opportunity* of becoming acquainted with them before the conclusion of the contract.³⁸⁴ This confirms our view that pre-contractual and contractual disclosure serve the same goal. An overdraft contract's formal (e.g. style of the document or frame) and substantial mark-up (e.g. language) may equally be adapted at the profile (or client-ID) of a particular borrower. A contract term that is transparent for a sophisticated borrower may be obscure to an illiterate consumer.³⁸⁵ Creditors should bear the burden of proof that a consumer actually was given an *opportunity* to examine all the terms³⁸⁶ as well as the fact that a borrower was able to understand how the *essential* contractual terms could affect his contractual rights and obligations. A pre-printed standard declaration stating that the consumer recognizes to be adequately informed is a largely insufficient evidence. A credit or current account agreement may - for example - clearly state whether a borrower has a right on an default exceeding his standard limit (i.e. option for the borrower to overdraw his limit upon payment) or whether such behaviour is considered as a default. Pre-contractual information equally serves as evidence. This results in both a *negative* and a *positive* information requirement for the professional. The negative transparency duty shall be interpreted as a negative obligation for a creditor to refrain himself from using unclear and misleading language. The positive information duty may be read as a duty to inform consumers about the

³⁷⁷ In the *Cofidis* Case, the ECJ failed to provide more clarity with regard to the exclusion of mandatory provisions. Advocate General Tizzano argued that the Directive was not applicable on a term - besides it involved the main subject matter of the agreement – given its nature as mandatory provision. The ECJ avoided to give a clear answer on this question regarding the Directive's scope. See AG Tizzano, opinion 18 April 2002, C- 473/00, *Cofidis S.A./ Jean Louis Fredout* and ECJ 21 November 2002, C-473/00, *Cofidis S.A./ Jean Louis Fredout*, [2002] ECR I-10875.

³⁷⁸ See Consideration 13 Unfair Terms Directive.

³⁷⁹ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 130.

³⁸⁰ The mandatory statutory or regulatory provisions exclusions was however included in the Liberal Professions Act.

³⁸¹ See *Consumer Law Compendium: Comparative Analysis of the Unfair Contract Terms Directive*, 383.

³⁸² See ECJ, 10 May 2001, C-144/99, Commission/ Netherlands, [2001] ECR 2001, I-3541.

³⁸³ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 137.

³⁸⁴ See article 31 Proposed Consumer Rights Directive.

³⁸⁵ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 139.

³⁸⁶ See Consideration Nr. 20 Unfair Terms Directive.



content of the contract terms, e.g. by orally summarizing them for a borrower.³⁸⁷ It seems inevitable that the costs of re-drafting (credit) contracts may give rise to a higher cost of credit for the consumer. One should however not overestimate the cost of aligning credit agreements with the requirements as indicated in this part, contract terms are constantly subject to legal changes what equally requires updating.

63. **THE PLAIN AND INTELLIGIBLE REQUIREMENT.** The plain and intelligible language requirement is a concretisation of the principle of transparency.³⁸⁸ The Unfair Terms Directive provides no clear guidelines as to how to apply its fairness test, nor how to interpret the plain and intelligible language requirement.³⁸⁹ Article 5 of Directive 93/13/EC stipulates that terms must be drafted in plain and intelligible language.³⁹⁰ It proves not easy to distinguish both complementing criteria.³⁹¹ *Plain* seems to refer to the fact that there are no possible ambiguities, misunderstandings or doubts concerning the content of a contractual term³⁹² or its consequence nor surprising elements³⁹³. It formulates the idea that a borrower should know what he can expect from the most essential clauses of the credit agreement.³⁹⁴

Intelligible, concerns the 'legibility' of a particular term³⁹⁵ and seems to refer to the ability for a borrower to understand the essential substance of a term.³⁹⁶ Intelligibility equally refers to the negative duty for a creditor to refrain himself from misleading a borrower about his obligations and duties under the agreement.³⁹⁷ Providing too much, and unnecessary information therefore violates the intelligibility requirement.

64. The plain and intelligible requirement should furthermore encompass both *formal* (see nr. 55 about framing) as well as *substantive* criteria. The formal requirement refers to terms drafted in a style that enables a consumer to understand essential rights and duties.³⁹⁸ For example frequent use of cross-references and length of the terms. An illegible print, caused by both side and colour must be prevented.³⁹⁹ Short sentences and clear and understandable subheadings regrouping similar contract issues, could reduce complexity for a borrower,⁴⁰⁰ as well as examples that explain some of the most essential credit terms. A summary may be provided (e.g. restricting itself to the core terms of the credit agreement). One should however be careful that such summary, however aimed at improving a borrower's ability to understand the most essential elements of the agreement is not misleading given the omission of some major elements.⁴⁰¹ The substantive (linguistic) requirement prevents terms to be in technical jargon, the use of too long sentences, fragmentary statements, etc.⁴⁰²

³⁸⁷ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 137.

³⁸⁸ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 136.

³⁸⁹ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 135.

³⁹⁰ Recital 20 adds that consumer should be given the opportunity to examine all the terms.

³⁹¹ H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 246.

³⁹² H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 246.

³⁹³ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 136.

³⁹⁴ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 136.

³⁹⁵ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 136.

³⁹⁶ H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 246.

³⁹⁷ H.-W. MICKLITZ, 'Unfair Terms in consumer contracts', in H.-W. MICKLITZ, N. REICH en P. ROTT (eds.), *Understanding EU Consumer Law*, Antwerpen, Intersentia, 2009, 136.

³⁹⁸ H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 246.

³⁹⁹ OFT Analysis of terms breaching Regulation 7 (plain English and Intelligible language).

⁴⁰⁰ OFT Analysis of terms breaching Regulation 7 (plain English and Intelligible language).

⁴⁰¹ E. MACDONALD, *Exemption Clauses and Unfair Terms*, Tottel Publishing, West-Sussex, 2006, 183.

⁴⁰² H. SCHULTE-NÖLKE, C. TWIGG-FLESNER and M. EBERS (eds.), *EC Consumer Law Compendium. The Consumer Acquis and its transposition in the Member States*, Sellier European law publishers, Munich, 2007, 246.



65. *NOT ALL PEOPLE ARE CAREFUL (CONTRACT) READERS*. An important question is to whom the contractual language should be plain and intelligible.⁴⁰³ The interpretation of intelligible should encompass the ordinary naïve and inexperienced borrower⁴⁰⁴, not lawyers.⁴⁰⁵ This implicates an objective standard.⁴⁰⁶ Credit terms must be understandable for an ordinary consumer without the latter has to seek legal advice.⁴⁰⁷ Latinisms as well as ‘Legalise’ language should be left as much as possible out the agreement and if inclusion is unavoidable, they should be translated into plain and intelligible language.⁴⁰⁸ The ECJ defined an average consumer as somebody ‘reasonably well-informed and circumspect’⁴⁰⁹ in a case involving national measures incompatible with article 28 EC. One could expect that the ECJ may redefine this term in a consumer protection case. The circumstances of the aforementioned internal market driven case may have to do with this definition, that might therefore sound completely different when interpreting the ‘consumer’ under Directive 93/13 EC – an instrument primarily aimed at consumer protection.⁴¹⁰ In its case law, the ECJ already indicated that some vulnerable consumers may require an elevated level of protection.⁴¹¹ Member States remain free to introduce or maintain a higher level of protection with regard to this notion, as well as to introduce a multi-layered approach.⁴¹²

IV. DEBIT INTERESTS UNDER THE BELGIAN LAW OF 14 MAY 2001

66. Interest rate ceilings were not included in the field covered by the Consumer credit directive. The European Consumer’s Organisation acknowledged the diffidence to agree upon such single rating cap at European level.⁴¹³ While *information* requirements with regard to the costs of credit fell prey to harmonization on Community level (see nr. 40-45), the Member States preserve their prerogative to establish or maintain *substantive* protection measures. When outlining the Belgian approach in this regard, we do not engage in the controversy surrounding usury laws.⁴¹⁴ In part II (B.), we tempered any high hopes one might have about an information regime regarding debit rates as laid down in the Law of 14 July 1998. With the enactment of the Law of 14 May 2001 regarding the regulation of the debit interest rates for current accounts (“Loi réglant les intérêts débiteurs dus sur les comptes à vue”), the Belgian Legislator recognized that mere disclosure is an insufficient means to protect consumers against the consequences of a negative balance on their current account.⁴¹⁵ By placing ‘a cap’ on the debit rate a *financial institution* is entitled to ask for overdraft services, the law forecloses *unlimited* freedom of the market for pricing.

67. Aimed at the protection of (1) consumers (2) holding a current account at a financial institution,⁴¹⁶ (3) that shows a negative balance (4) which falls out of the scope of the Belgian Consumer Credit Code, the scope of the Law largely corresponds with that of the Law of 1998.⁴¹⁷ In contrast with the

⁴⁰³ E. MACDONALD, *Exemption Clauses and Unfair Terms*, Tottel Publishing, West-Sussex, 2006, 181.

⁴⁰⁴ See H. COLLINS, ‘Good Faith in European Contract Law’, OJLS, 1994, 248.

⁴⁰⁵ OFT Analysis of terms breaching Regulation 7 (plain English and Intelligible language).

⁴⁰⁶ E. MACDONALD, *Exemption Clauses and Unfair Terms*, Tottel Publishing, West-Sussex, 2006, 181.

⁴⁰⁷ FSA statement on using the words ‘consequential loss’ in general insurance contracts.

⁴⁰⁸ E. MACDONALD, *Exemption Clauses and Unfair Terms*, Tottel Publishing, West-Sussex, 2006, 181.

⁴⁰⁹ See ECJ Case C-210/96 *Springenheide v Amt für Lebensmittelüberwachung*, 1998, ECR I-4657.

⁴¹⁰ P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 140.

⁴¹¹ See ECJ Case 382/87, *Ministere Publique v. Buet* [1989], ECR 1235.

⁴¹² P. NEBBIA, *Unfair contract terms in European Law*, Oxford, Hart, 2007, 141.

⁴¹³ See BEUC (European Consumer’s Organisation), *Credit for Consumers – BEUC Position*, November 2002, 6-7.

⁴¹⁴ For an introduction on this topic: see for example: C. L. PETERSON, ‘Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion of American Credit Pricing Limits’, *Minn.L.Rev.*, Vol. 92, 1110-1163.

⁴¹⁵ Wet van 14 mei 2001 tot regeling van de debetrente op zichtrekeningen, *Belgian Sate Gazette* June 13, 2001. (hereafter referred to as ‘Law of 2001’). From December 2010 on, this law will equally be abolished due to the expanded scope of the renewed Consumer Credit Code.

⁴¹⁶ Or Belgium’s Postal Service.

⁴¹⁷ See article 2 Law 2001.

latter- it doesn't police debt services offered by *non-financial institutions*⁴¹⁸, that nonetheless remain entrusted at the Belgian Consumer Credit Code (if the amount of the debt service exceeds the threshold for the Code's application⁴¹⁹). Inevitable, some debt services offered by non-financial institutions will remain subject the general civil law regime.⁴²⁰ Notwithstanding its apparently narrow field of application – i.e. those negative balances that are not subject to the regulations by the Consumer Credit Code- the Law's potential value shouldn't be underestimated. From all the services financial institutions offer to their retail clients, current accounts are by far the most accessible. We mentioned before that the possibility to overrun a current account is often included in the standard personal account package. The possibility that a financially troubled consumer with several current accounts at different institutions incurs - small - amounts of debt on each of them is therefore not far-fetched.⁴²¹ We ascertained that an appeal on an already existing overdraft facility saves consumers the diffidence of applying for credit (see nr. 14).

68. As to the substance, the Law restricts the debit rate both for *authorized* and *unauthorized* overdraft use by a current account holder. For an *authorized* overdraft, the maximum debit rate is determined by reference to the maximum APR applicable for overdraft facilities under the Consumer Credit Code: the annual debit rate that a financial institution is allowed to charge for an authorized overdraft on a current account may not exceed the maximum APR applicable to open-end overdraft facilities below € 1250.⁴²² Article 3 clarifies that no other sum could be charged for the use of this overdraft. Of course this 'cap' may not be read as a prohibition to charge current account holders an annual management fee for their account.⁴²³

69. The contractual penalty in case of an *unauthorized* overdraft may not exceed the contractually agreed debit rate for authorized overdrafts by more than 10 percent.⁴²⁴ An example could illustrate this principle: suppose that a current account holder is allowed to overdraw his account for an amount of 1249 EUR (a prevailing sum, given creditors interest to stay below the Consumer Credit Code's radar). The contractually agreed rate for such authorized overdraft is 12 percent. Suppose that at a given date, the current account however shows a debit balance of € 1400. If this contractual agreed debit rate doesn't exceed that legal cap, the financial institution is allowed to charge the account holder a debit rate of 12 percent for the sum corresponding with the authorized overdraft. For the unauthorized (part of the) overdraft – (1400- 1249= €151) - the financial institution may charge at debit interest rate up to 13, 2 percent (12 % + (10 percent of 12 %)).

The Law equally introduces both an *administrative* and *civil* sanction for the non-respect of its provisions. As long as a financial institution fails to comply with the Law's prescriptions, it is not allowed to ask the current account holder *any* (not even the contractual agreed-) charge for the debit balance.⁴²⁵ Supervisory authorities should monitor financial institutions' compliance (see also nr. 57 in this regard).

70. In our opinion, the Law of 2001 could be applauded. While introducing substantive protection against potential exploitation of the more vulnerable borrowers, it does not adversely affect current account holders that never or rarely indebt themselves (targeted paternalism). More sophisticated consumers remain free to negotiate the applicable credit terms with their financial institution (e.g. a higher credit amount, reducing the possibility to

⁴¹⁸ Current accounts require the possibility for the current account holder of making a deposit. However many non-financial institutions offer debt services to their customers, little of them will link this option with a possibility of making deposits.

⁴¹⁹ Article 3§1, 4° of the Belgian Consumer Credit Code excludes today from its scope any overdraft facility for an amount below 1250 EUR repayable within a period of at the most 3 months. This exclusion was modified given the transposition of the Consumer Credit Directive. From December 1 2010 the Belgian Consumer Credit Code is principally applicable on all overdraft facilities.

⁴²⁰ See for example article 1153 Civil Code.

⁴²¹ See R. STEENNOT, 'De Wet van 14 mei 2001 tot regeling van de debetrente op zichtrekeningen', Artikelsgewijze commentaar financieel recht, Afl. 27, Commentaar bij artikel 2, nr. 3.

⁴²² See article 3 Law 2001. Currently this maximum amounts to 15 percent. We ascertained that nearly all overdraft facilities in Belgium are construed as open-end agreements.

⁴²³ See R. STEENNOT, 'De Wet van 14 mei 2001 tot regeling van de debetrente op zichtrekeningen', Artikelsgewijze commentaar financieel recht, Afl. 27, Commentaar bij artikel 3, nr. 3.

⁴²⁴ See article 2 Law 2001

⁴²⁵ See article 5 Law 2001



incur a contractual penalty rate). The risk that financial institutions will increase the annual management fee for current accounts seems however inevitable. Moral hazardous behaviour, to be expected when the interest rate for default (a current account holder has after all no right to *unauthorized* overdrafts - under Belgian Law they could be qualified as a contractual breach) is too low, may be tackled by financial institutions' ability to terminate the current account agreement immediately upon the occurrence of an unauthorized overdraft. If a financial institution on the other hand fails to terminate the agreement, nonetheless the current account shows an unauthorized overdraft, one might reason that such overrunning shouldn't be qualified as a default, but as an *additional finance option* offered to their account holders.⁴²⁶ In such reasoning, the Law's cap precludes the abuse of the "default argument" to overcharge consumers. Finally, the regulations clarity could, besides contributing to legal certainty, also be cost-reducing for financial institutions enhancing out-of court enforcement.

V. CONCLUSION

71. In our first theoretical part we observed that informational market power and exploitation of consumers' cognitive limitations may lead to an unjustified distortion of the theory of equal bargaining power between creditors and an (overdraft) borrower and that such distortion might be welfare reducing, even in the absence of a 'smoking gun' linking consumer credit to personal insolvency. We underlined that more research is required to obtain superior information, about how markets for consumer credit and their agents function. Consumers equally need to be safeguarded against self-harm causing actions. While exploring some boundaries of information disclosure as a means to protect borrowers, we empathized that formal transparency should be exceeded (among other things by making use of new IT solutions and incorporating plain and intelligible language in the credit documentation). Credit regulation should incorporate behavioural evidence and may be aligned with product regulation. Multi-layered protection (including point of sale disclosure and tailored monthly statements) is to be preferred over the prevailing one-size fits all approach. A strict regulatory dichotomy between regulation with regard to a consumer's assets and debts seems superseded. If light touch regulation is insufficient to remedy consumer's imperfect rationality, more substantial regulation is the obvious means. The Belgian Law of May 2001, capping debit rates for overdraft use linked to a current account, proves to be a useful instrument in this regard, as well as article 15 of the Belgian Consumer Credit Code stipulating that a creditor is only allowed to extend credit if he reasonably could assess that the borrower will be able to meet his contractual obligations. Policymakers and the industry should let go old dogma's and engage in a constructive dialogue leading to enduring solutions. Responsible borrowing and responsible lending remain however indiscerptible from each other.

⁴²⁶ O. BAR-GILL, 'Informing Consumers About Themselves', *Law & Economics Research Paper Series Working Paper* N° 07.-44, 23.

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