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Consumer Overindebtedness and Consumer Law in the European Union

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Introduction

Consumer overindebtedness has become a central legal policy issue among European Union Member States over the past decade. At the beginning of the 1990s, the European countries were hit by a deep economic depression. The consequences of this economic setback were aggravated by an increase in indebtedness in private households during the preceding decade. In addition to low income families, many middle class households ran into serious economic difficulties because of home mortgages, small business loans, personal guarantees of business and private loans, and consumer debt.

In this situation, governments have been under pressure to evaluate existing safeguards for overindebted households and to find new solutions to the problem. **Legal developments** in this field have been rapid throughout the nineties, both at the national and European Union level. At the **national level**, the most notable development has been the appearance of *judicial debt adjustment laws* (consumer bankruptcy) in several central and northern European countries. The law of overindebtedness, however, includes a broader framework of legal protection, including consumer protection in the credit market, debt collection and debt enforcement law.

At the **European Union level**, the legal framework has changed with the Treaty of Amsterdam which brought issues of judicial co-operation into Union law. The development in the insolvency law and cross-border enforcement of judgements has been rapidly changing at the beginning of the new century.

The European Community commissioned its first study on overindebtedness in 1991. This study, published in 1994¹, focused on facts about consumer overindebtedness and, in particular, recommendations for a European approach towards consumer debt adjustment law. The Anglo-American consumer bankruptcy laws, including provisions on discharge, were used as an important point of reference. While many of the findings of that study still hold, the past decade has shown that European countries have somewhat different policy approaches to overindebtedness. Especially, there seems to be a universal acceptance in the Member States that

1 Huls, N., et al.: Overindebtedness of Consumers in the EC Member States: Facts and Search for Solutions, Kluwer Éditions Juridiques Belgique, Centre de Droit de la Consommation, Diegem, Louvain-la-Neuve 1994

prevention of overindebtedness is at least as, if not more, important a goal as rehabilitation of overindebted debtors.

This study combines the two approaches, prevention and rehabilitation. In this regard, it is essential that **overindebtedness** is seen **as a social process**. The main reasons for overindebtedness can be conceptualized in many ways; unemployment, business failures, personal problems, such as illness and divorces, or excessive consumption. These events do not turn consumers into overindebted debtors overnight. Rather, the process goes through several stages, and certain decisions made before the debtor is hopelessly indebted. The debtor's coping strategies are extremely important but the creditors' actions are also of equal importance. Lending practices often contribute to the process of overindebtedness. Also debt collection practices play a crucial role, either by allowing the debtor to make ends meet or by turning a situation that is difficult to cope with into an unmanageable one. A wide range of legal regulations that contribute to this process.

Prevention of Overindebtedness

While debt adjustment laws form the legal framework for the rehabilitation of overindebted consumers, it is however less clear what is meant by preventive measures. We acknowledge the crucial importance of adequate social and health policies (consumer bankruptcy in the United States is sometimes described as the ultimate social safety network), but in this study we focus on the legal measures that can be utilized to prevent overindebtedness.

The following have traditionally been included in **preventive legal safeguards**:

- consumer protection laws,
- laws that oblige commercial creditors to give debtors information and to respect debtors' interests in certain situations,
- regulations on interest rates, default interest, collection fees, debt enforcement etc.

As specified in the guidelines given by the European Union, this study examines

"in detail the preventive and remedial measures to prevent or correct excessive debt, particularly with regard to general procedures for granting consumer credit, including all ways in which credit lines or accounts can be exceeded, the payment facilities linked to credit or payment cards as well as the payment facilities granted by gas, water, electricity, telephone or telecommunications suppliers in general. The following measures are particularly important: advice given to consumers, information and training about credit and

managing household finances, and all the provisions provided within the credit cycle. Concerning the latter, the following should be noted: information to be provided to the consumer should his payment be late, suspension of the right to credit withdrawals or to the supply of gas, electricity, water, or any other basic service or good, being able to consult databases on consumer debt or a possible obligation to do so, the responsibilities of lenders, credit intermediaries or any other creditor with regard to (excessive) consumer debt, the role, powers and legal situation of debt mediators as well as the control and management of secondary effects of (excessive) debt, such as the failure to pay mandatory insurances, or having credit and access to basic financial services refused. Legislative provisions (or the lack of them) concerning debt recovery and the regulation of this professions must also be examined.”

However, preventive measures increasingly *include educational programmes which* focus on household financing, financial planning, credit and debt, as part of school curricula and adult education provision. Other measures include *special credits* offered to low income households, and refinancing for overcommitted private debtors by public and private financial and social institutions.

Rehabilitation of Debtors

Several European countries introduced *laws on judicial debt adjustment (consumer bankruptcy)* during the 1990s. Such laws have been enacted, for example, in Austria (1993), Germany (1994; in force 1999), the Netherlands (1997), Belgium (1998), Luxembourg (2001) and four Scandinavian countries. England (1990) and France (1989) have also introduced laws to regulate and alleviate situations of overindebtedness and similar legislation is on the way in Italy and Portugal. The study examines these laws in detail and gives a comparative account of the different regulations adopted.

Cross-border Effects

The study also examines the actual and possible impact of the current legislative situation in terms of the working of the internal market (access to cross-border services for consumers, access to national markets for professional workers, conflicts of jurisdiction between national laws with regard to procedures for payment facilities and collective settlement of debt or civil bankruptcies), once again bearing in mind observance of the rules of competition.

The Authors of the Study

The study involved major research institutes in this field from each Member State. *Prof. Dr. Udo Reifner*, Institute for Financial Ser-



vices (iff) e.V., Hamburg, *Prof. Dr. Nick Huls*, Erasmus University Rotterdam, and *Dr. docent Johanna Niemi-Kiesiläinen*, University of Helsinki, have the joint responsibility for this report of the research project, which was coordinated and administered at iff by *Helga Springeneer*, and *Prof. Dr. Udo Reifner*. All four mentioned are the authors of this study.

An important part of the work has been compiled by experts in the Member States. They supplied legal documents, scientific information, literature, background information and were supportive in rectifying our interpretation of their information. The following experts participated:

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Austria:	Dr. Hans W. Grohs, ASB Schuldnerberatungen GmbH, Linz
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Sweden:	Mikael Melqvist, Judge, Svea Hovrätt

The Scope of the Study

The study consisted of four parts: extensive information gathering from the Member States, compilation of the information into a data bank, evaluation of the data with clarifications from the informants and drafting of recommendations.

The first aim of the project was to compile the information on relevant legislative sources in this field. To this end an extensive questionnaire was prepared and sent to the cooperation partners in all Member States. The completed questionnaires form the basis for the data bank now accessible – but keyword protected – at <http://docman.money-advice.net/>.

Comparison and evaluation of the legislation were carried out by the scientists in charge with the assistance of Helga Springeneer (LLM).

We want to thank the European Union for the opportunity to do this study. We also thank our prominent experts in different

Member States for a speedy completion of the long questionnaire. Also our translators and the staff of the Institute for Financial Services deserve our thanks. They performed their tasks quickly and with expertise.

I Theoretical Approach: Overindebtedness

As a social phenomenon, consumer overindebtedness is a situation in which consumers will definitely not be able to meet their financial obligations in the near future. It is defined by an overall deterioration of their and their dependants' economic situation and will gradually lead to social exclusion, higher cost of living ("the poor pay more") and less participation in overall economic development and social progress.

It is distinct from the legal term of insolvency or "bankruptcy", which is defined from the creditors' viewpoint² as the impossibility of realising receivables because of a negative debt to assets ratio and a lack of liquidity.

Insolvent consumers may not be overindebted if their families and friends can help them, if they still have access to new credit or recourse to other resources, and if they want to use them. Instead solvent consumers may be overindebted because the burden of debts due in the future will gradually lead to deterioration in their living conditions.

While there is no definition of bankruptcy or overindebtedness in the European Insolvency Regulation most EU Member States still focus on the traditional definition of insolvency as a gateway for debt settlement procedures while some countries, such as *France* and the *Scandinavian* states, employ definitions which already take into account the social perspectives of the debtor.

Table 2: Definitions of Insolvency

Austria	§ 66 Austrian Bankruptcy Code (1) The opening of the bankruptcy proceedings presupposes that the debtor is insolvent. (2) Insolvency is to be accepted in particular if the debtor stops his payments. (3) Insolvency does not presuppose that creditors crush. The circumstance in which the debtor satisfied demands of individual creditors totally or partly or still can satisfy, does not of itself justify the acceptance that he is solvent.
Belgium	To be incapable of paying his/her debts
Germany	The consumer must be unable to pay. § 17, para.2 Insolvency Act defines "Illiquidity" if the debtor is unable to meet his due obligations to pay, whereby illiquidity

² Still visible in the traditional German denomination "Konkurs" (bankruptcy) which is derived from the Latin word "concurrere" meaning that creditors "come together".

	shall be presumed as a rule if the debtor has stopped payments. Imminent illiquidity shall also be a reason to open insolvency proceedings. The debtor shall be deemed to be faced with imminent illiquidity if he is likely to be unable to meet his existing obligations to pay on the due date (§ 18, para.2 Insolvency Act).
Great Britain	The inability of the debtor to pay the debt on which the petition is based, or in cases where the debt is not immediately payable, or the debtor appearing to have no reasonable prospect of being able to pay the debt.
Luxembourg	Experiencing long-term financial difficulties, in order to address all of his/her non-business debts which have fallen due for payment.
Portugal	Impossibility on the part of debtors to comply with their obligations on time, due to lack of means and lack of credit. (art. 3 and art. 8/1, sub-para. a).
Spain	A person is obliged to declare bankruptcy if debts are greater than assets and he is forced to stop paying his current obligations.

Table 3: Definitions of Overindebtedness

Denmark	Debtors without assets who are caught in the deadlock of permanent indebtedness.
Finland	Insolvency means other than temporary inability of the debtor to pay his debts as they become due. The following shall be taken into account when assessing the ability of the debtor to pay: 1) the funds from the liquidation of the assets of the debtor; 2) the income of the debtor and his earning potential, in view of his age, working capacity and other circumstances; 3) the necessary living expenses of the debtor; 4) the maintenance liability of the debtor; and 5) the other circumstances affecting the financial status of the debtor
France	"The manifest impossibility for a debtor in good faith to meet his/her debts taken as a whole as they fall due and payable." Case law: individuals are overindebted if repayment of debts reduces their minimum income requirement (the amount which cannot be seized or the Revenue Minimum d'Insertion (income support level)).
Sweden	The Adjustment of Debts Act (1994:334) includes other than temporary inability of the debtor to repay his debts as they become due. An additional criterion is that there are special reasons for granting adjustment. Consideration is here given to the length and reason of indebtedness and to the efforts by the debtor, to the best of his ability, to reach agreement on an instalment schedule with the creditors.

Overindebtedness is thus a relatively new phenomenon which is gradually moving away from the traditional legal approach of insolvency and bankruptcy. While the latter views the consequences of insolvency for the creditors, laws that address overindebtedness of consumers view these problems primarily as problems of the debtor and his family. In the following table the Irish description of different competences concerning issues of overindebtedness may be the most adequate. Most countries still allocate issues of overindebtedness to the Ministry of Justice (*Austria, Germany, the Netherlands, Sweden*) and the Ministry of Economics and Finance (*Italy, Belgium, France, Greece*), while some have created additional competence within the Ministry of Social affairs (*Luxem-*

bourg, Germany, the Netherlands, Ireland, Spain) and others within the Departments of Consumer affairs (Portugal, Spain).

Table 4: Ministry in Charge of Overindebtedness

Austria	Federal Ministry of Justice
Belgium	Service Public Fédéral des Affaires Economiques
Denmark	Bankruptcy Act: The Ministry of Justice (Justitsministeriet) Consumer Credit Agreement Act: Consumer Protection Agency (Forbrugerstyrelsen) and the Consumer Ombudsman (Forbrugerombudsmanden)
Finland	Ministry of Justice (Debt Adjustment Law) Ministry of Trade and Commerce (Consumer Agency, Debt Counselling)
France	Minister of Finance and the Economy
Germany	Federal Ministry for Family, Seniors, Women and Youth; Federal Ministry of Justice has the legislative jurisdiction.
Great Britain	Department of Trade and Industry, Office of Fair Trading
Greece	The Ministry of Development, Subministry of Trade, General Secretariat of Trade, General Department of Consumer Protection. (no department for overindebtedness)
Ireland	Justice, Equality and Law Reform: law reform Finance: Central Bank; Financial Services Regulatory Authority Enterprise, Trade and Employment: consumer credit directives and Office of the Director of Consumer Affairs, Department of Social and Family Affairs - Sole funder of and responsible for the network of independent Money Advice and Budgeting Services (MABS)
Italy	Ministero delle attività produttive (before named Ministero dell'Industria)
Luxembourg	Ministère de la Famille, de la Solidarité Sociale et de la Jeunesse - Service Solidarité
Netherlands	Ministry of Justice: legislation Ministry of Social affairs: for informal debt assistance
Portugal	Assistant Minister of the Prime Minister: consumer issues. Consumer Institute (Instituto do Consumidor): application of consumer protection policy.
Spain	Ministry of Health and Consumer Affairs via the National Institute of the Consumer Municipal Consumer Information Offices (local) Bank of Spain: financial entities Commission for Client Defence
Sweden	Department of Justice

Beyond insolvency and overindebtedness, other distinctions govern national legislation.

Overindebtedness is attributed to different factors, such as supplier behaviour, and debtor behaviour, or objective factors, such as income stability. This is why some legislation is focussed on information asymmetry between providers and consumers (informational consumer protection), other on a rationing of credit for people who are not creditworthy (cash society approach), while yet other legislation pinpoints improvident credit extension by unskilled and scrupulous personnel (responsible lending approach) as a major aspect requiring legislation. Another approach can be seen in the acceptance of overindebtedness as a normal result of

market competition which has to be dealt with market instruments (bankruptcy approach) while others seek remedies by adapting credit contracts to inescapable social risks (social consumer protection).

A further important difference is also evident in the goals of the regulation which can be prevention of overindebtedness at an early stage, compensation for its consequences, rehabilitation through advice and help or exclusion from further access to credit.

Finally, the attitude towards the law may differ depending on whether an adjudicative court centred or a mediated out-of-court procedure is involved. Another variation would be a social welfare approach where debtors are taken into the care of state agencies until they recover.

As a rule, all of these approaches underlie national regulations relating to overindebted consumers, but it would be worthwhile identifying which philosophy prevails or was at least intended to prevail. When actually applied many rules serve goals other than those intended. The philosophies of European consumer insolvency laws are discussed also in subchapter II.D.2 below.

Table 5: Philosophies on Overindebtedness

Dimension	Assumption	Indicators	Denomination
Problem	overindebted insolvent	disadvantaged persons unpaid debts („not paying“)	„poor“ „lazy debtor“
Concept	prevention compensation	contract law; supervision bankruptcy law	„consumer protection“ „social welfare“
Means	information credit prohibition responsible lending fresh start social protection	wrong decision credit overload insufficient scoring no assets regard for social risks	„inexperienced“ „overindebted“ „improvident“ „bankrupt“ „excluded“
Procedure	adjudication mediation rehabilitation	court procedures out-of-court settlements welfare administration	„decided“ „consented“ „cared“

In the legislation covering overindebtedness and consumer bankruptcy, the titles of the laws already indicate the different attitudes and philosophies.

Table 6: Legislation on Overindebtedness and Consumer Bankruptcy

Member State	Legislation	Title Keyword
Greece	No specific regulation	
Finland	Act on the Adjustment of Debts of Private Individuals	Adjustment
Austria	Bankruptcy Law	Bankruptcy
Ireland	Bankruptcy Act, 1988	Bankruptcy
Portugal	The Código dos Processos Especiais de Recuperação da Empresa e de Falência, of 1993 (art. 27 adapts to consumer bankruptcy)	Bankruptcy
Spain	Ley de 26 julio 1922, Suspensión de Pagos: only for commercial bankruptcy but Proyecto de Ley Concursal 23 de julio de 2002 (Proposal)	Bankruptcy
Germany	Insolvency Act (Insolvenzordnung) of 5.10.1994, Bundesgesetzblatt Teil I, 2866. In force since 1 January 1999.	Insolvency
Great Britain	Insolvency Act 1986 County Court Act 1881	Insolvency
Italy	Art. 1186 civil code; Art. 5 bank law "insolvency" (no specific regulation)	Insolvency
France	Loi relative à la prévention et au règlement des difficultés liées au surendettement des particuliers et des familles. In force 1 March 1990. In 1993, subsequent articles L331-1 to L333-8 Consumer Protection Act	Prevention
Luxembourg	Law of 8 December 2000 concerning the prevention of overindebtedness and introducing a procedure for the collective settlement of debts in cases of overindebtedness.	Prevention
Belgium	Loi du 5 juillet 1998 sur le règlement collectif des dettes Moniteur belge 31 July 1998, p 24.613 and Loi du 5 juillet 1998 modifiant les articles 628 et 1395 du Code judiciaire, Moniteur belge, 31 July 1998, p 24.623	Regulation
Denmark	Gældssanering, Danish Bankruptcy Code, Konkurslov (part IV, Gældssanering p 197-237) from July 1984	Rehabilitation
Netherlands	Wet schuldsanering natuurlijke personen, Fallissementswet [Bankruptcy Act] artt.284-362. Dutch Bankruptcy Act consists of three titles: faillissementen [bankruptcy], surcéance van betaling [suspension of payment], schuldsanering [sanitation of debt]. This act is to be amended.	Rehabilitation
Sweden	Skuldsaneringslag 1994	Rehabilitation

I.A EU-Policy

I.A.1 Community Policy on Overindebtedness

In its December 2001 declaration on consumer credit and debts, the European Council declared overindebtedness a major concern of the European Union. The essence of the declaration could be summarised by the following extracts:

"Credit is a **driving force** for economic growth and the welfare of consumers, it also constitutes a **risk** for credit-providers and a threat of **additional cost and insolvency** for a growing number of consumers; ...

Over-indebtedness is in the majority of cases due to increasing uncertainty regarding the occurrence and predictability of **variations in income**; ...

Ten European Union Member States currently have specific legislation concerning the **collective settlement of debts** governing the social, legal and economic treatment of over-indebted consumers, whereas ordinary debt collection procedures continue to apply in the other Member States ...

A certain **harmonisation of preventive measures** concerning the rules on **information** for debtors, the **responsibility** of credit-providers, compensation and **costs** if contracts are not fulfilled and the role of credit **intermediaries** or agencies (should be considered);...

Exchange of information at European level, particularly as regards the level of indebtedness and best practice;..."

In this declaration the European Union properly reflects the reasons and remedies for overindebtedness outlined in various research projects³ throughout the world.

Consumer overindebtedness as such is seen in four dimensions:

- The general development of the modern economy into a credit society (**need for credit**)
- Income variations menacing the stable repayment of debts (**employment risk**)

3 For a **European overview**, see *Reifner, U./Ford, J.* (eds): Banking for People, Vol. 2: Overindebtedness, Unemployment and Policy Responses - National Reports, de Gruyter: Berlin, New York 1992, p 315-648. See also from the same source the follow-up conference in Birmingham: *Hörmann, G.* (ed): Consumer Debt in Europe - The Birmingham Declaration: Proceedings of the Third European Conference on Overindebtedness, Birmingham Settlement 1993. For the **UK**, see *Ford, J.*: The Indebted Society: Credit and Default in the 1980s, Routledge: London 1988; *Berthoud, R./Kempson, E.*: Credit and Debt: The PSI Report, Policy Studies Institute: London 1992; *Lord Crowther*: Consumer Credit: Report of the Committee, HMSO: London 1971. For **Austria**, see *Institut für Gesellschaftspolitik der Arbeiterkammer*: Privatverschuldung in Österreich - Konsumentenkredite zwischen Wunderwelt und Offenbarungseid, Vienna 1990; *Mosslechner, P./Brandner, P.*: Ökonomische Aspekte der Verschuldung privater Haushalte, Österreichisches Institut für Wirtschaftsforschung: Vienna 1992. For **Germany**, see *Korczak, D./Pfefferkorn, G.*: Forschungsvorhaben zur Überschuldungssituation und Schuldnerberatung in der Bundesrepublik Deutschland - Final Report, Kohlhammer: Stuttgart 1990; *Institut für Finanzdienstleistungen*: Schuldenreport 1993 - Die Verschuldung der privaten Haushalte in Deutschland, Luchterhand: Kriftel 1994; *Institut für Finanzdienstleistungen*: Der neue Schuldenreport - Kredite der privaten Haushalte in Deutschland, Luchterhand: Kriftel 1995; *Holzschek, K./Hörmann, G./Daviter, J.*: Die Praxis des Konsumentencredits in der Bundesrepublik Deutschland - Eine empirische Untersuchung zur Rechtssoziologie und Ökonomie des Konsumentencredits, Bundesanzeiger: Cologne 1982. For **Belgium**, see *Domont-Naert, F.*: Le Surendettement des Consommateurs en Belgique - Rapport Final 1993, Centre de Droit de la Consommation: Louvaine-La-Neuve (with support from Febecoop and the National Bank of Belgium); *L'Observatoire du Crédit et de l'Endettement*: Prévention et Traitement du Surendettement en Région Wallone, L'Oberservatoire de Crédit et de l'Endettement 1996. For **Finland**, see *Niemi-Kiesiläinen, J./Tala, J./Wilhelmsson, T.*: Kuluttajien Velkasaneeraus - Tarve ja mahdollisuudet (Consumer Debt Advising, Restructuring of Debts and Discharge in Finland - an Analysis of Consumer Debt Situation and a Proposal for a Model of Legislation), Oikeuspoliittinen Tutkimuslaitos No 106, Helsinki 1991. For the **United States of America** and **Canada**, see: *Caplovitz, D.*: The Poor Pay More - Consumer Practices of Low Income Families - The Cost of Paying Later, The Instalment Plan, Free Press of Glencoe: New York 1963; *Caplovitz, D.*: Consumers in Trouble - A Study of Debtors in Default, The Free Press: New York 1974; *Duhaime, G.*: La vie à crédit, Montreal 2003 (in print)

- Incomplete decision making process of consumers: lack of information about products, own wishes and ability to repay (**informational and educational deficiencies**)
- Mere profit driven credit extension without regard to these effects at disproportional costs (**irresponsible lending**)

To address these problems the Council refers to four instruments:

- More information about overindebtedness and models to cope with these problems in the Member States (**information and research**)
- Consumer information, cost control, responsible lending (**consumer protection**)
- Supervision of intermediaries (**administrative approach**)
- Collective settlement of debts (**procedural law approach**)

While in the first part of the research, commissioned by the earlier cited statement of the Council, the Commission investigated the prospects of European-wide data on overindebtedness⁴, the present report concentrates on the legal aspects of overindebtedness which have already been addressed by the same authors in their 1994 report to the Commission on Overindebtedness of consumers in EC Member States: facts and search for solutions⁵ (hereinafter referred to as *1994-Overindebtedness Study*). At that time, overindebtedness was not yet considered an issue of immediate concern for EU regulation.

As far as bankruptcy law was concerned, art. 1 (2) no.2 of the Brussels Convention of 1968 on Jurisdiction and Judgments⁶ still excluded bankruptcy law from its scope of application. Meantime the EU Insolvency Regulation was passed⁷, including the recognition of insolvency proceedings of individuals, opening the door for further regulations concerning consumer bankruptcy in line with similar regulatory developments in most Member States. The present report will show that in this field enormous progress has been made towards unified procedures, and harmonisation does seem to be possible.

4 *Betti, G./Dourmashkin, N./Rossi, M.C./Verma, V./Yin, Y.*: Study of the Problem of Consumer Indebtedness: Statistical Aspects, Contract No. B5-1000/00/000197, London October 2001

5 Cf. footnote 1

6 Convention of Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, 1990 O.J. (C 189) 2

7 European Union: Convention on Insolvency Proceedings, 23 November 1995, 35 I.L.M. 1223 (1996). For further details see subchapter I.A.2 below.

In contract law, even further development can be observed in the preventive element for regulating overindebtedness. The Consumer Credit Directives 78/102/EEC, 90/88/EEC, as amended by Directive 98/7/EC⁸, did not even mention overindebtedness. They were focused on consumer information and consumer choice to facilitate competition and transparency. Although some provisions relate to unfair terms, credit advice, and cooling-off periods, we did not in 1994 consider it the appropriate place for regulatory measures aimed at preventing overindebtedness.⁹

With its 2002 Proposal for a totally revised Consumer Credit Directive¹⁰, the European Commission directly addresses the problem of overindebtedness of consumers.

"The directive will improve stability by putting in place a draft of provisions on responsible lending, on providing information and protection both when the credit agreement is concluded and during its performance (or in the event of its possible non-performance) that will reduce the probability of a creditor or credit intermediary being able to mislead consumers in another Member State or jeopardise their financial situation or even of acting irresponsibly. The directive being proposed, and in particular its provisions relating to the prevention of overindebtedness, together with the rules on consulting central databases, will further improve the quality of loans and lessen the risk of consumers falling victim to disproportionate commitments that they are unable to meet, resulting in their economic exclusion and costly action on the part of Member States' social services."

The Commission intends to achieve three goals:

- adaptation of the old directive to new techniques of credit extension
- new distribution of rights and duties between consumers and creditors
- guarantee of a high level of consumer protection within the framework of a joint regulation which enables the industry to further develop its potential

8 OJEC L 42/48 of 17 February 1987 and L 61/14 of 10 March 1990

9 In 1994 we wrote: "... we do not suggest to amend Directive 87/102 in this direction. The Consumer Credit Directives are mainly concerned with supplier-consumer relations in individual credit transactions. Consumer overindebtedness, ..., is frequently a problem of multiple debts." (*Huls, N., et al.*: cf. footnote 1, p 226)

10 Proposal for a Directive of the European Parliament and of the Council on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers, from 11 September 2002, COM(2002) 443 final; 2002/0222 (COD)

Although not explicitly addressed in art. 1 on the aim of the directive¹¹ the prevention of overindebtedness is apparent behind many of the articles.

The directive will for the first time regulate debt-related factors such as credit brokerage, sureties, and risk-related decisions for credit extension and debt collection. But the leading philosophy of these preventive measures will remain information. Some articles, such as lenders liability for irresponsible lending and limitations on guarantees, a stronger protection of guarantors, interdiction of doorstep-selling of credit and supervision of brokers, indicate national efforts made by Member States that have long opted for direct and strict rules.

Core elements of national regulation for the prevention of overindebtedness such as usury ceilings, capped default interest rates, protection against credit cancellation, liability for unfair refinancing or a right of access which are seen as social instead of informational consumer protection rules have been left out. Furthermore, the directive does not address debts in general, for example, arising from mortgage loans or other services. Such regulation is expressively left to the national legislator¹², while in terms of informational rules, the proposed directive calls for total harmonisation.

Alongside this consumer approach, the European Commission also considers overindebtedness as a problem of social exclusion.¹³

I.A.2 International Procedural Law on Insolvency

Internationalization and globalization of markets and businesses has had a profound effect on the environment in which debts are recovered, people and businesses are indebted and insolvencies occur. This development also concerns consumers and other private debtors. Consumers travel frequently, make purchases while abroad, buy things through the internet and by mail-order from companies in other countries, take credit from international banks and credit companies and so on. In addition, since persons increasingly move from one country to another and work in a coun-

11 "The aim of this directive is to harmonise the laws, regulations and administrative procedures of the Member States concerning agreements covering credit granted to consumers and surety agreements entered into by consumers."

12 Comment concerning art. 30: "National-level provisions covering maximum or exorbitant APRs or any other type of setting or evaluation of maximum or exorbitant rates may continue to apply. This directive does regulate this area." (p 27)

13 See European Commission, Employment and Social Affairs DG, Call for proposals VP/2002/010 for transnational exchange projects under the Community Action Programme to Combat Social Exclusion 2002-2006 (Official Journal of 23.04.2002, 2002/C 98/10, p 7/167)

try other than their country of residence, international debt recovery has become more and more widespread.

Overindebtedness also has cross-border effects. If legal regulations are not coordinated, overindebted persons may have counterproductive incentives to work abroad and move from one country to another. Overindebted persons may seek to move to escape the collection efforts of their creditors. The new consumer insolvency laws may also create incentives not to move if the discharge achieved in one country is not respected in another. Even forum shopping, that is, moving to a country with the most favourable insolvency regulations, may occur. Thus, overindebtedness may be a noticeable obstacle to the free movement of labour in the Member States.

Most areas of law related to recovery of debts and insolvency have traditionally been strictly national. The internationalization of legal regulation in this area started during the last decade of the last century, especially in the European Union.

The legal activity of the Union was made possible by changes to the European Union Treaty during the 1990s. Cooperation in the legal area was increased by the Maastricht (1992) and Amsterdam (1997) Treaties. Following these changes, arts. 61 and 65 of the Treaty Establishing the European Union stipulate that the Council shall adopt measures in the field of judicial cooperation. In these measures shall include, for example, in civil matters, (1) improving and simplifying the recognition and enforcement of decisions in civil and commercial cases and (2) promoting the compatibility of the rules applicable in the Member States concerning the conflict of laws and of jurisdiction.

Thus, after Amsterdam, both enforcement of judgements and cross-border effects of bankruptcies can be regulated by Union instruments and, as will be explained in the following, the Council has already made regulations in both regards.

I.A.2.a) Cross-border Recovery of Debts

In European Union law, the point of debt recovery is usually that of creditor protection. For the efficiency and development of the internal market it is essential that creditors are able to recover extended credit in other countries. International debt recovery through the courts has already been regulated by the Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters, signed on 27 September 1968 in Brussels, and thus known as the Brussels Convention. All Member States

were parties to the Convention prior to new Member States joining the Union in 1995.¹⁴ Even the new Member States were parties to the regulation through Lugano Convention which was signed on 16 September 1988. The material provisions of Lugano Convention are virtually identical to the Brussels Convention, and the Lugano Convention still has relevance for countries that have not joined the Union but are members of the European Free Trade Association (Iceland, Norway, Switzerland, and also Poland).

After Amsterdam, jurisdiction in civil matters and cross-border enforcement of judgements was regulated by Council Regulation. In practice, it meant that the material provisions of the Brussels Convention were transformed into a Council Regulation (EC 44/2001) in December 2000.¹⁵

The content of the regulation is not identical to the Brussels Convention, but the basic principles of the two documents are quite similar. There has therefore been notable continuity in the regulation over a period of more than thirty years, notwithstanding the change in the legal form.

The regulation covers jurisdiction and enforcement of judgements in commercial and civil matters, including consumer credit, sale of goods to consumers and insurance contracts. Consumers, insurance beneficiaries and employees are treated as weaker parties in the relationship and special provisions for their protection have been drawn up (preamble 13).

As a rule, jurisdiction is based on the domicile of the defendant (art. 2). While the regulation generally allows the parties to a contract to agree upon jurisdiction (art. 23), this possibility is largely curtailed when the defendant is a consumer. In principle, a claim against a consumer has to be brought in the courts of the country where the consumer is domiciled. An agreement on another jurisdiction (prorogation) is allowed only after the dispute has already arisen (art. 17.1). Thus, it is not possible to agree on jurisdiction in the original contract on which the claim is based.

The consumer may bring charges in the courts of the country in which he himself is domiciled (art. 16.1). Thus, in a dispute against a provider of goods or a lender, a consumer may sue in his own country. A consumer may also sue in the Member State, in

14 The Brussels Convention has still relevance in relation to Denmark, which opted out of the Council Regulation.

15 Council Regulation (EC) No 44/2001 of 22.12.2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (OJ L 12 of 16.1.2001); http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_012/l_01220010116en00010023.pdf.

which the provider has a branch, agency or establishment, in a dispute which arises out of the operations of that branch (art. 15.2). Agreements which give the consumer alternative jurisdictions in which to bring a claim against the other party are also allowed (art. 17.2).

Besides jurisdiction, the regulation also provides for a feasible system of recognition and enforcement of judgements given by a court in another Member State (Chapter III of the Regulation). Basically, judgements given by a court in another Member State are recognized in other Member States without any legal proceedings. If need arises, an interested party may apply for a recognition in the court (art. 33).

The enforcement of judgements requires a simple court procedure leading to a declaration of enforceability (art. 41). The defendant need not be notified of the proceeding's before the court declares the decision enforceable (art. 42.1), but the defendant has a right of appeal, which must be processed in contradictory proceedings (art. 43). The recognition or enforcement of a judgement may be challenged only on a limited range of grounds, such as being manifestly contrary to public policy, which is hardly ever the case among Member States, or failure of service to the defendant (arts. 34, 35 and 43).

Furthermore, the Regulation allows the applicant to avail him/herself of provisional and protective measures before the declaration on enforceability has been given or while an appeal is pending (art. 47).

Thus, the Regulation facilitates the enforcement or "free movement" of judgements among the Member States.

The Regulation does not apply to bankruptcy or other judicial insolvency proceedings of companies and other legal persons (art. 2). Judicial debt arrangements of private persons or consumer bankruptcies are not specifically mentioned in the exception clause, but it appears be self-evident that these kinds of arrangements are not covered by the regulation.

I.A.2.b) International Bankruptcy Law

International and cross-border effects of bankruptcies have been acknowledged for a long time. There are examples of business bankruptcies with wide cross-border effects dating back to the Middle Ages. Notwithstanding, bankruptcy law has traditionally been strictly national. The international effects of a bankruptcy have been regulated in national bankruptcy codes as part of international private and procedural law of the respective country, if at

all. International agreements on the recognition of a bankruptcy in another country have been rare. An example is the Scandinavian Bankruptcy Convention of 1933 which is still in force. Regional bankruptcy agreements have also been concluded in Latin America. Bilateral agreements between some European countries have been concluded since the 19th century.

This lack of cooperation is surprising given the importance of bankruptcy law to the development of the common market. Historically, the importance of unified bankruptcy law for a common market was acknowledged in the United States Constitution (1789), which allocated the power to enact laws on bankruptcy to the federal level. Also, a bankruptcy code was one of the first legal products of the united *Germany* in 1877.

Efforts to formulate and conclude a European agreement on bankruptcy started in the 1960s. Initial efforts were aimed at harmonizing elements of the bankruptcy laws of the Member States. This aim, however, turned out to be too ambitious, and the drafting had a low profile for almost two decades.

There was renewed interest in international bankruptcy law in 1990, both in the Council of Europe and the European Union. Harmonization of bankruptcy law was no longer on the agenda - instead, the concern was to regulate the cross-border effects of bankruptcies, that is, recognition of bankruptcy proceedings opened in another Member State and conflict of laws concerning issues relating to the bankruptcy.

The European Convention on Certain International Aspects of Bankruptcy was signed in 1990 under the auspices of the Council of Europe.¹⁶ The convention never came into force but it had an important influence on the European Union convention which was drafted at the beginning of the 1990s.¹⁷ The European Union Convention on Insolvency Proceedings was opened for signatures on 23 November 1995. This convention never came into force either¹⁸, but an essentially identical Council Regulation was passed on 29 May 2000.

16 European Treaty Series No. 136, signed 05.06.1990.

17 About its history, see for example *Fletcher, I.F.*: Historical Overview - The Drafting of the Regulation and its Precursors, in: *Niss, Fletcher & Isaacs* (eds), *The EC Regulation on Insolvency Proceedings. A Commentary and Annotated Guide*, Oxford University Press 2002.

18 It was signed by all Member States except the United Kingdom.

I.A.2.c) Council Regulation on Insolvency Proceedings

The European Union Council Regulation on Insolvency Proceedings¹⁹ is binding on all Member States, except for *Denmark* (preamble 33). The basic principle of the Regulation is the recognition of bankruptcy proceedings opened in one Member State in all other Member States. In addition, the Regulation contains a comprehensive regulation of conflicts of laws concerning assets in another Member State.

The Regulation was drafted with business bankruptcies in mind and its scope of application is designed accordingly. In principle, both legal persons and natural persons can be debtors under the Regulation. The Regulation applies to collective insolvency proceedings which entail partial or total divestment of a debtor and the appointment of a liquidator (art. 2). These qualifications as such do not preclude insolvency proceedings concerning private and consumer debtors from the scope of the Regulation. In concrete terms, the issue as to who may be a bankruptcy debtor is determined under national law (art. 4.2 (a)). While Member States have different insolvency proceedings for different debtors and slightly different purposes, the regulation applies to specific proceedings which are enumerated country by country in Annex A to the Regulation. Each Member State notified the EU regarding which procedures are included in Annex A.

Member States have adopted different positions concerning the application of the Regulation to existing insolvency proceedings for consumers. The first group of countries, consisting of *Belgium* and the *Netherlands*, have decided that the Regulation applies to their consumer debt adjustment proceedings, which are mentioned in Annex A. As regards the second group, *German* and *Austrian* Restschuldbefreiung proceedings are not specifically mentioned in Annex A, but since they are a (possible) stage in the respective insolvency and bankruptcy proceedings, mentioned in Annex A, they come under the scope of the Regulation.²⁰ As regards the third group of countries, including *France*, *Finland*, *Luxembourg*, and *Sweden*, there is no mention of their consumer debt adjustment proceedings in Annex A, and since these proceedings are regulated in specific laws and do not fall under the proceedings mentioned in the Annex, the Regulation cannot be applied to

19 Council Regulation (EC) No. 1346/2000 of 29.05.2000 on Insolvency Proceedings (http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l_160/l_16020000630en00010018.pdf)

20 Specifically, both countries mention in Annex C Treuhänder (trustee) as a liquidator mentioned in the Regulation art. 2 (b). According to the laws of both these countries, Treuhänder is the trustee in discharge proceedings concerning natural persons.

them.²¹ As more and more Member States are drafting their consumer insolvency laws, we anticipate an increase in the last mentioned group of countries.

These differences in the scope of application are quite illogical and the present state of regulation can hardly be defended. It seems clear that both a review and a reform of the Regulation of the recognition of the consumer debt adjustment schemes and discharge provisions are necessary.

Since overindebtedness is a serious impediment to the free movement of labour, the recognition of the consumer insolvency proceedings and discharge in other Member States should be the goal of such a review.

I.A.2.d) The Regulation and Consumer Debts

The basic alternatives for regulation are the inclusion of consumer debt adjustment schemes under the Insolvency Regulation, a specific Union regulation on recognition of consumer debt adjustment, an international agreement to the same effect and the corresponding harmonization of national laws with international private law. The basic regulatory alternatives will be laid out below, and the strengths and weaknesses of each will be discussed briefly.

While it is not currently unusual for a consumer debtor seeking relief from debt adjustment proceedings to have different financial relationships in other countries, the nature of and problems relating to these relationships differ from those of a typical business debtor in bankruptcy.

As in business bankruptcy, a central problem is how possible assets located in another country can be accessed and included in the debt adjustment procedure. The assets of a private debtor are usually quite different, however. He may own a car or a house in another country. Then the crucial question is which assets the debtor is allowed to keep and which assets are sold for the benefit of the creditors and how this is best done. In practice, however, the debtor is obliged to cooperate with the trustee as a condition of the discharge, which greatly facilitates the realization of the assets. The practical problem may turn out to be how the trustee obtains information about assets located in other countries.

A common problem in consumer insolvency is that the debtor works in a country other than his country of residence. With the freedom of movement, debtors may also move to another country

21 From the point of view of discharge, it has to be mentioned that France, Great Britain and Ireland, unlike Finland and Sweden, have a discharge provision in their commercial insolvency law which comes under the Regulation.

during the debt adjustment process. In such situations, problems relating to stay of enforcement proceedings in another Member State and to the formulation of the payment plan have to be addressed.

An additional problem is that the payment plan may take several years to complete and the debtors are likely to move during that time. A move to another Member State is likely to change debtors' circumstances and their ability to fulfil the plan. What legal consequences the move has on the plan and whether the plan can be modified, depends on what law is applied. Even though these differences in the situation warrant some caution, the Insolvency Regulation also seems to have some advantages concerning consumer debtors.

In particular, the Insolvency Regulation offers a comprehensive package for the effects of proceedings in another country. Thus, it might be a feasible solution to widen the scope of the Regulation to include all consumer insolvency proceedings.

It is doubtful whether the Regulation, which is designed for business bankruptcies, is actually the most suitable for the recognition of debt adjustment proceedings. In particular, the functional definition of insolvency proceedings in the Regulation does not fit well with the generally accepted purposes of consumer debt adjustment. The Regulation applies to proceedings that entail the partial or total divestment of a debtor and the appointment of a liquidator (art. 1.1). The main purpose of debt adjustment is, on the contrary, to rehabilitate the debtor and provide the opportunity for a new economic start. Rehabilitation should be achieved with the minimum curtailment of the creditors' interests and, thus, a sale of non-protected assets may be part of the arrangement. A divestment of the debtor, however, is never the main function of consumer insolvency proceedings. To speak of "divestment of debtor" is hardly appropriate language in the context of debt adjustment.

Equally unfamiliar is the use of the term liquidator (art. 1.1 and art. 2 (b)). While a trustee or equivalent is appointed in most debt adjustment proceedings, his main tasks are information gathering, drawing up a payment plan and supervising its fulfilment. The liquidation of a debtor's assets, if the term can be used at all, is only one, albeit occasional, task of the trustee in consumer insolvency proceedings.

When we look at the Regulation from a practical point of view however, many individual articles of the Regulation seem to be particularly applicable in debt adjustment proceedings. For example, it is quite reasonable that creditors' rights in rem regarding

assets situated in a country other than that in which the insolvency proceedings are opened, are not affected by the proceedings (art. 5). Also, the concern that all assets are brought to the proceedings is a legitimate one and is actually taken into account in the Regulation.

Some important issues are not mentioned in the Regulation. For example, there is no reference to the situation where debtor works in a country other than that of residence. In addition, adjustment of the plan, which runs for several years, is often required but the issues involved are not addressed in the Regulation at all.

Many other provisions in the Regulation, such as secondary proceedings, are clearly superfluous in relation to debt adjustment. Since these provisions can be simply ignored in a consumer insolvency case, this is hardly a serious problem.

Another option is to draft a specific Regulation for consumer insolvency. There would, however, be considerable overlap, since some national procedures are already included under the Insolvency Regulation.

Agreement on the international aspects of consumer insolvency does not seem plausible in the light of the fate of European insolvency conventions in the 1990s. The harmonization of national consumer insolvency laws does not seem to be a realistic alternative either. European debt adjustment laws differ widely as will be seen in chapter II.D of this report.

Thus, from a practical point of view, there seems to be a case for the inclusion of consumer insolvencies under the Insolvency Regulation.

However, the functional approach of the Regulation should be reconsidered. Liquidation is not now an appropriate way to describe the functions of business insolvency proceedings that include the goal of company reorganization. The functional approach is important for the interpretation of the Regulation. Thus, if the Regulation is also applied to consumer insolvency proceedings, there is the danger that the interpretation will be guided too much by the interests of business bankruptcies if the functional approach is not changed.

A review of the Regulation in terms of consumer insolvencies should also be made. Firstly, there may be provisions that might yield undesired outcomes if applied to consumers. Secondly, international recognition might suggest that some common policies should be adopted by national legislators in the Member States.

I.A.3 Principles of Overindebtedness Law

I.A.3.a) The Principles of European Contract Law Projects

In December 1999, after nearly twenty years of preparation, the Lando Commission presented its Principles of European Contract Law (PECL). This work was inspired by the American restatements of the Law. Many European private law scholars are presently co-operating in a follow-up project that covers other fields of private law (The Von Bar Project). These projects include both consumer and commercial law and the participants have adopted a functional approach.

The PECL project focuses on “freedom of contract” while concepts such as “good faith” and “fair dealing” are conceived as a means of compensating for a formalist approach towards rules and rights. There are also sections on “the duty to cooperate” and “excessive benefit” or “unfair advantage”. One commentator (Hesselink)²² concludes that the principles are more “social” than most European civil codes.

Although both projects are not explicitly aimed at strengthening the position of the debtor, the intellectual approach taken, might also be appropriate for rules in the field of overindebtedness and bankruptcy. Obviously bankruptcy is closely related to the core of contract law, e.g. force majeure and lifelong liability for debts. Up till now (collective) procedural law has not been part of such a European approach, but that might change in the future (see I.A.2.b) above). In the past, several general principles have been developed specifically for insolvency. These general principles are a useful starting point for a European endeavour in this field.

I.A.3.b) Principles from the Cork Report (1982)

The *1994-Overindebtedness Study* took the following principles from the Cork Report of 1982:

- to recognise that we are living in a society based on credit, which has brought us great prosperity; this requires – as a necessary result – proceedings to remedy the accidents of the credit society;
- it is better to diagnose and treat imminent insolvency at an early rather than at a late stage;
- protection of the debtor and his family from undue demands and harassment by their creditors, and at the same time, to

²² Hesselink, M.W.: Principles of European Contract Law, Preadvies voor de vereniging voor burgerlijk recht, Kluwer Deventer 2001

have regard for the rights of creditors, whose position can also be threatened;

- to prevent conflicts between individual creditors through a distribution of the proceeds among all creditors;
- to realise the non-exempt assets of the insolvent which should properly be taken to satisfy his debts, with the minimum of delay and expense;
- to establish and encourage professional and independent debt-counselling;
- to determine the causes of overindebtedness and, if fraudulent behaviour is found, to take suitable measures;
- to guarantee the public interest which is at issue in cases of insolvency;
- to lower unproductive costs of ineffective debt-collection.

I.A.3.c) Principles in the Consumer Debt Report (INSOL 2001)

At the 2001 World Congress in London, INSOL (International Federation of Insolvency Professionals) presented its Consumer Debt Report, prepared by a Committee chaired by Jan Van Apeldoorn. Experts from all over the world contributed to this work.

The principles and recommendations are as follows:

I.A.3.c)(1) The First Principle: A fair and equitable Allocation of Consumer Credit Risks

Society should accept that consumer debtors who cannot repay their debts, for reasons beyond their control, are not always solely to blame and that the creditors that consequently receive little or no payment are not necessarily the only victims. Society and legislators have to determine:

- **Levels of exemption:** the property excluded from recourse by the creditors
- **Avoiding powers:** to nullify certain acts and to redress any damage detrimental to the interest of all the creditors
- **Automatic stay or moratorium:** which prohibits the creditors pursuing actions against the debtor whilst a solution is being sought
- **Anti-discrimination provisions:** safeguarding a humane approach to the debtor and his entitlement to maintain, both during and after proceedings, a decent way of living, even at the cost of his creditors

The object of the law is to provide for a **discharge or fresh start** for the consumer debtor who cannot reasonably repay his creditors, provided that the debtor acted in good faith, both as to the way the debts arose and as to the reason, the debts cannot be repaid. The components must be:

- **Fair and equitable:** There should be a fair allocation of risks between debtor and creditors in a predictable and equitable way. The system should not be abusive to debtors and not necessarily designed just to protect and maximize value for creditors. It should contain a balanced approach to give the debtor the possibility of a second chance. Apart from the excluded property that will remain with the debtor, the entire estate should be available for the creditors. The law should therefore provide the trustee or administrator with sufficient powers to nullify avoidable actions. The INSOL Report recognizes that there are differences between creditors and their rights, but does not make recommendations about priorities, securities or preferred creditors.
- **Efficient:** Although consumer debtors come from all income groups, they seldom have seizable estates. Complicated and time-consuming procedures should therefore be avoided. The administration of the estate must be undertaken by a skilled, efficient trustee or administrator.
- **Cost-effective:** A decision may have to be made as to who pays for the process, the trustee and the other costs involved. Where a fair and equitable bankruptcy or rehabilitation process is for the benefit of society as a whole, costs may have to be shared by all the stakeholders.
- **Accessible:** The debtor should have easy access to the procedure without costs being an obstacle to those who need the relief that such systems offer and without numerous or complicated formalities. They should be free to choose between a bankruptcy or rehabilitation procedure, provided both systems are available to a consumer debtor. Since debtors typically initiate insolvency proceedings only as a last resort, powers to initiate proceedings are sometimes given to creditors, governmental or other authorities, including social security agencies.
- **Transparent:** Debtors and creditors alike must be able to monitor the process, have the opportunity to be heard, to receive notices and to exercise their rights. Public confidence in the process depends on transparency. Regard must be had for requirements for privacy.

Further attention should be given to the following issues:



- **Size of the estate:** The law will determine which assets of the debtor will be available for distribution among the creditors and consequently which assets will be excluded. The debtor should be able to maintain a reasonable standard of living. Where the law provides for a redemption capacity, the excluded income of the debtor is set according to a standard that the necessary living expenses (food, housing, public facilities, medical care, etc.) of the debtor and his dependants can be met. Since the high costs of housing (either rent or mortgage) are often contributory causes of the insolvency, special attention should be given to the problems connected with housing.
- **Duration of proceedings:** In some jurisdictions, the redemption capacity is saved over a period of years before the funds so accumulated are distributed among the creditors in exchange for a discharge. The amount of income available to the debtor in such situations is usually minimal and often below the minimum standards that apply to the debtor in question. The underlying philosophy is that the debtor should endure some financial hardship, whereupon the discharge is considered as the reward. This period can be as long as seven or eight years. This period however, should not be over-extended. Debtors have quite often experienced long periods of financial hardship before proceedings started. The risk that the debtor will not be able to cope on a limited budget available, especially in times of misfortune, unexpected costs, etc. and will relapse into overspending is realistic. The law should accommodate unusual circumstances.
- **Avoiding powers:** Creditors should not be able to retain transfers received from the debtor within a certain period before insolvency procedures and which interfere with the principle of equal treatment of creditors.
- **Automatic stay of action:** Creditors should be prohibited from pursuing the debtor during the insolvency process otherwise creditors who choose not to be bound by the process would prevail over those utilizing the collective mechanism.

In addition, the law should take into account the issues that are generally provided for in any fair and predictable insolvency law. In this respect, reference is made to provisions regarding the handling of encumbered assets and the position of secured creditors, treatment of contracts (where special attention should be given to contracts related to the basic necessities of life) and the priority of distribution.

The law may provide for **different routes to a discharge** depending on the specific situation of the debtor and the nature of the debtor's financial difficulties. A debtor who has no redemption capacity, who suffers from survival debts and who has no prospects of improving his financial situation within a reasonable period (possibly due to prolonged dependence upon social security benefits, permanent unemployment or disability), will require a different approach to a debtor with only accommodation debts. Where the insolvency is likely to be only temporary, provided the debtor is given breathing space, he should be allowed an opportunity to restructure his earnings and spending. In the first situation, there is no benefit from extending insolvency procedures for a longer period, thus extending the agony of a hopeless situation. A debtor with only accommodation debts, however, may be able to offer his creditors a pro rata payment of their claims or even a composition or scheme of arrangement. In the first situation, bankruptcy-type procedures seem more appropriate, and in some jurisdictions, a consumer debtor may apply for a discharge after a very short period, whilst for the second situation, a rehabilitation procedure could be the answer. Many countries with well developed consumer insolvency laws have chosen either system or a combination thereof. The choice usually depends on the way insolvency laws are structured in general and has often been determined historically. A debtor should be free to choose, and either procedure should lead to both a discharge and a solution for the underlying causes of the debt problems. A debtor is not necessarily helped when a discharge is easily obtained without the underlying causes being solved or taken away.

Consumer insolvency laws are about human beings with debt problems. These may arise from consumer debts or may be related to the debtor's participation in the economic process in a **small business**. The extent to which a natural person will be held liable for debts which arise from his participation in the economic process will largely depend upon the national system adopted, both with regard to the distinction between natural and legal persons, and to the legal and organizational forms in which a business may be conducted. A legal entity conducting a business, whether large or small, may cease to exist after the termination of insolvency proceedings, together with the remainder of any unpaid debt. However, where the business is in any way identifiable with a natural person who remains responsible for the debts of the business after insolvency, the person's situation may not be different from any other consumer with debt problems. Nevertheless, the specific circumstances of a small business and the type of debt may be quite different. The business may have a different type of

creditors, may be engaged in all kinds of commercial transactions, etc. Solving these specific situations could require different approaches, as to the way the business should be dealt with, attempts at rehabilitation (within the national system) and as to the specific skills of the trustee or administrator.

The majority of consumer debtors will have assets and creditors only within their own jurisdictions, but some will have assets and/or creditors in other jurisdictions. This may occur when people do not live and work in the same country or in areas with intensive **cross-border** transactions between adjoining states or jurisdictions. In areas where trade barriers have disappeared and there is free movement of people, goods and services (and credit) from abroad will be easily available. In addition, the Internet brings the world to everyone's doorstep. Various treaties relating to the recognition of insolvency procedures between countries include the recognition of consumer debtor insolvency laws. The UNCITRAL Model Law on Cross-border Insolvency ensures judicial cooperation, access and recognition, but the Guide to Enactment allows enacting States to exclude insolvencies that relate to natural persons residing in the enacting State and whose debts were incurred predominantly for personal or household purposes, rather than for commercial or business purposes, from the scope of any domestic law. Nevertheless, the UNCITRAL Model Law could be beneficial for both consumer debtors and creditors where the debtor has assets and/or creditors in other jurisdictions. Under the EU-Insolvency Regulation²³, natural persons/consumer debtors are not excluded as such, but it is left to the laws of the contracting States as to whether they fall within the scope of the application. Recognition of foreign proceedings alone, however, may not be sufficient. The legal conditions under which a discharge can be obtained differ considerably from jurisdiction to jurisdiction. Some jurisdictions require minimum dividends to creditors. In others, even a zero rate dividend qualifies as a dividend for discharge purposes. If these differences are too great, a foreign discharge may be considered contrary to public policy and therefore not binding on a creditor who retains the ability to pursue the debtor in another jurisdiction. Overall uniformity or harmonization of consumer insolvency laws may not be a realistic objective, but it would assist if a greater level of standardization could be achieved.

23 See I.A.2.c) Council Regulation on Insolvency Proceedings on p 31 ff.

I.A.3.c)(2) The Second Principle: Discharge, Rehabilitation, "Fresh Start"

Providing a fresh start to a debtor who cannot reasonably repay all of his pre-existing debts is the recognition by society that overindebtedness is, in many cases, excusable. It is a key element of any consumer debtor insolvency law or rehabilitation procedure, based on the principle that it is in society's interest that the debtor should be able to have a fresh start, free from past financial obligations and not suffer indefinitely. Fresh start in the context of this study does not share the assumption that a debtor will truly start anew when freed from his debts. The insolvent debtor will continue to act in his economic environment using the capacities offered to generate income and to save costs. This aspect of the fresh start doctrine is dealt with below.²⁴ It is therefore crucial for this aspect of social life that insolvency procedures provide tools for advice and help during the period following the declaration of insolvency. Debt advice, a supervised rehabilitation period, financial education, and social help to find sources of income and to manage household expenditures more properly, have to be equally provided during this period of rehabilitation. Such possibilities go beyond discharge. A mere discharge may even be detrimental to these goals, if it leaves the former debtor alone without addressing the causes which have led into overindebtedness. This is also the reason, why all European countries do not only have a waiting period for the next discharge, but also a waiting period between the declaration of insolvency and the effective discharge. Fresh start, as it is addressed in this chapter, means a **fresh start in credit and debt** alone, which is only one but certainly a crucial element of the debtor's social life. It shall help to regain confidence into and by the economic actors and to develop a new and more solid credit history, which provides again access to financial services and to the labour market.

Fresh start thus reflects the distinction between the punishment philosophy of yesteryear and the economic reality of the twenty-first century. In this respect, attention should be paid to the following issues:

- **Contributions to the estate:** A debtor may have to contribute parts of his income to the estate or his creditors either during the insolvency proceedings, which in some jurisdiction may take a considerable time, or after these proceedings have been terminated, by way of an imposed condition on the debtor. Ideally, the debtor's ability to obtain a discharge should not be

24 See below I.B.1 Insolvency Law and Contract Law on p 46 ff.

linked to the debtor's income after the termination of the proceedings.

- **Extent of discharge:** The discharge should cover as many debts as possible that exist at the beginning of the proceedings or at the time that the discharge is obtained. In many jurisdictions, however, certain debts are excluded from a discharge, such as debts arising from maintenance agreements, fraud, court fines, taxes, and student loans. Although there can be a social justification for such exceptions, they should be kept to a minimum. A discharge with too many restrictions and surviving debts may not sufficiently assist the debtor in making a fresh start. Testing whether the debtor acted in good faith could be more appropriate in some circumstances.
- **Waiting period:** The waiting period is the minimum period between two discharges permitted by law. In some jurisdictions, a discharge is a once in a lifetime opportunity. In other jurisdictions, there is a minimum waiting period, for example ten years, before a debtor will qualify for a new discharge, or even to enter insolvency proceedings which may lead to a new discharge.
- **Restrictions imposed:** Conditions may be imposed upon the debtor either during the proceedings or as a condition for a discharge, either by way of recommendation by the trustee, the administrator or the court, including restrictions on the ability to obtain new credit, to leave the country or to carry on a business for certain period of time. Although these restrictions may be for the good of the debtor, they should not restrict the debtor in his fresh start.

I.A.3.c)(3) The Third Principle: Extra-judicial rather than Judicial Proceedings

There are obvious advantages in preferring extra-judicial to judicial proceedings where both are available on substantially the same terms. Extra-judicial or out-of-court proceedings take less time of the courts and the judiciary, are less expensive and can be better designed for a more integrated approach of the problems the consumer debtor is facing, which are more often of a non-legal than of a legal nature. In general, there should be de-legalization and de-juridification of consumer debtor problems.

Extra-judicial proceedings have clear advantages for both debtors and creditors. In such proceedings, a creditor should be assured that he would receive that to which he is entitled under judicial proceedings, that his rights are protected and dealt with in an effective and efficient manner. For a debtor it should be clear which



sacrifices are required to be made and that by doing so, he is entitled to a discharge and that the creditors will accept this.

This may require facilitating out-of-court schemes of arrangement or rehabilitation procedures that mirror the provisions of full insolvency laws:

- **Anti-abuse provisions:** A number of debtors or debts may be denied the benefits of a discharge, although these should be limited and well defined. In general, this is a consequence of fraudulent activities by the debtor.
- **Reaffirmation of debt:** A debtor and a creditor may reaffirm the debtor's obligation previously discharged. In some jurisdictions, these contracts are not enforceable. In other jurisdictions, the debt is not discharged, but remains in existence in a form referred to as a "natural obligation".

Approval of such schemes or procedures can be given in cases where creditors' unanimous approval would otherwise be required, but such a vote is not obtainable. A dissenting creditor should be able to be overruled if his position in and the outcome of extra-judicial proceedings are not materially different from judicial proceedings. This is likely to be the case when extra-judicial proceedings have incentives for both parties. These procedures will be less expensive and less time-consuming.

In some jurisdictions, it is compulsory that efforts are being made to effect an out-of-court settlement before court proceedings will be started. A consumer debtor is not allowed to enter into an insolvency procedure leading to discharge, unless he shows to the satisfaction of the court that an out-of-court settlement could not be obtained.

The same result could be obtained by introducing a "cooling-off" period, allowing the parties, through mediation or another form of alternative dispute resolution, to attempt to reach a settlement or rehabilitation plan.

Special attention should be given to the costs involved and the necessity for debtor's representation. For a debtor, costs should never be an obstacle to solving his debt problems through an extra-judicial procedure.

The problems a consumer debtor faces are often complex and usually not only of a legal but also of a socio-psychological nature. This requires the input of professional independent debt counselors, specialised in negotiating arrangements with creditors and knowledgeable about the specific problems of consumer debtors. Their work requires expertise in the legal, financial and social as-

pects of consumer debt problems and they should be able to give information and advice on all aspects of budgeting-assistance, debt settlement and welfare laws.

Governments, quasi-governmental or private organizations should create bodies to train, finance and supervise these professionals, to develop standardized norms and practices and codes of conduct, against which the assistance is tested. This requires licensing and supervision by the court or an independent body. Special attention should be given to the remuneration of trustees, administrators and/or debt counsellors to ensure that sufficient time is available to assist the debtor in a proper manner.

Since consumer debtors are often in a weak and vulnerable social position, they easily become victims of unprofessional or even corrupt debt counsellors.

I.A.3.c)(4) The Fourth Principle: Prevention

Although the attitude towards insolvency has changed over the last decade, especially among young people, insolvency still carries a stigma that can, however, be avoided. It requires the cooperation of legislators, local and national governments, lenders and creditors' associations together with representatives of debtors in

- Setting-up financial educational programmes,
- critically reviewing how, to whom and under which conditions credit is made available,
- monitoring the debt collection process,
- generally improving the social environment,
- data-collection and publication to ensure transparency and an understanding among stakeholders.

Based on the principle that prevention is better than cure, informed advice on the technicalities of credit installments, credit cards, large expenditures, etc., financial educational programmes may be a compulsory element of a discharge and may be offered on a voluntary basis, either pre- or post-insolvency. Educational programmes may range from budgeting advice, budgeting support or budgeting administration. Special attention should be given to vulnerable groups of society, including the young, the elderly and minorities.

Lenders should be very much aware that they are in a position to influence the risks taken by consumers. By using accurate scoring models, lenders are capable of controlling their risks and reducing their costs. However, through aggressive marketing and sophisticated solicitation techniques, they reach less and less credit-

worthy debtors and higher charge-off rates. These charge-off rates are just part of the business of the lender and are taken into account in the conditions under which credit is made available. For the consumer debtor who cannot repay his debts, it may result in a personal tragedy. Lenders should therefore be clear about the conditions subject to which credit is made available. Tightening standards will result in slower consumer debt growth for consumers in the danger-zone and will consequently reduce consumer loan delinquencies. Lenders should however also regularly review their own codes of conduct on all levels, including the way credit is marketed and their collection tactics.

Monitoring of consumers with debt problems by a body controlled by representatives of both lenders and consumer organizations will ultimately be beneficial for all parties.

Data collection will ensure transparency and an understanding of how the system is operating and, recognizing privacy, data on debtors and creditors are therefore essential. Statistics will reveal important information that will assist the parties to the system and society as a whole. Such a body would have to operate under strict conditions and guarantee privacy for consumers while providing reliable information to lenders about previous delinquencies to protect consumers and improve the efficiency of the credit system. In addition, organizations should make arrangements to provide reliably accurate credit reporting and scoring information to individual debtors to enable them to understand the credit system better.

I.A.3.d) Conclusions

The above-mentioned principles reflect the common core of consumer bankruptcy policies for the near future. The Lando-project proves that it is possible at the European level to identify core values in legal systems even although they differ deeply in their detailed regulations.

The work that has been done by the INSOL Consumer Debt Committee presents the international consensus about sound law and policy in insolvency matters. These principles constitute a solid basis on which European scholars and practitioners can build.

In chapter II of this report the European consumer insolvency laws will be analysed. On that basis general principles will be presented in subchapter III.B.2 that can be drawn from these laws and the aspirations that the legislator have had. Our principles have the same foundations as the INSOL principles. Since our principles are developed in the European context, they are more concrete and adapted to the European environment.



We do not think the time is ripe for a European regulation of consumer insolvency law, nor can we see any urgent need for such regulation. However, as will be discussed in chapter III.B.3, as the Member States and new Member States will be enacting their laws in the near future, cooperation, sharing of best practices and development of general principles will be needed also in this field of law.

I.B Legal, Economic and Social Approaches

I.B.1 Insolvency Law and Contract Law

At the turn of the 19th century, the development of dependant labour and mass migration into the cities created the need for money investments for lower classes. Businesses responded by offering sales with payment by instalments in the form of either instalment purchase (i.e. *Germany*) or hire purchase (i.e. *Great Britain*). While loans were still inaccessible for consumers and usury laws prevented their spread, instalment payments were also seen as problematic and unnecessary. Many European states regulated instalment credit within contract law to prevent the availability of credit for consumers.

It was only after World War II that bank loans became a possibility for consumers. Restrictive bank legislation on interest rates was lifted in the sixties because it seemed no longer necessary to exclude the “unproductive use” of savings as consumer credit had been labelled before.²⁵ The consecutive explosion of consumer credit led to national legislation first in *Great Britain* with the Consumer Credit Act 1974, built on the experiences of the 1968 US Consumer Credit Protection Act. While many countries extended their instalment credit or hire purchase act to new forms of linked credit it was mainly due to the EU initiative that consumer credit legislation spread all over Europe in the nineties.²⁶

It was widely assumed that consumer credit could be kept under control by improved information rights, regulation of usury and default as well as through bank supervision. It was not so much the rise of consumer credit but more the development of mass and long term unemployment which led to serious problems of overin-

25 Interest rate regulation on consumer credit was abolished for example in Germany 1963, in Greece 1989, in Luxembourg 1963. In Ireland, Credit Unions still regulate interest rates (Credit Union Act 1997).

26 **Greece:** Joint Decision of Ministers of National Finance, Justice and Trade of F1 983-1991; **Germany:** Consumer Credit Act 1991 (now art. 491 ff Civil Code); **Denmark:** Consumer Credit Agreement Act; **Ireland:** The Consumer Credit Act 1995; **The Netherlands:** Wet op het consumentenkrediet, Staatsblad 1997, 63; **Italy:** Bank Law; **Spain:** embodied the Directive 87/102/CEE and later by Law 7/1995; **Sweden:** Consumer Credits Act 1992:830; **France:** Code de la Consommation

debtedness which, within the old systems of debt enforcement and bankruptcy, left consumers with life long debts and dependency. A number of empirical research studies on the "Indebted Society"²⁷, "The Practice of Consumer Credit"²⁸, or "Banking for People"²⁹ following David Caplovitz' work on "The Poor Pay More"³⁰ and "Debtors in Default"³¹, expressed public concern of what some people termed modern "peonage".

A subsequent stage in this development has been the rise of consumer bankruptcy schemes in the 1980s and 1990s.³² While it was initially a limited instrument of last resort to give relief to those few for whom contract law had no remedies, since the late 1990s its mass application has gradually replaced consumer protection law. Under these schemes, a judge can grant discharge from debts.

In fact consumer bankruptcy is not just a logical consequence of granting bankruptcy to trade and industry. The idea of bankruptcy in the economy was – in economic terms – the elimination of the debtor from the market. Economic players who are not able to honour the basic assumption of contract law – that you have to have money and that nobody should be able to claim that he was not able to honour his debts – should leave the market place. Enterprise organised in accordance with the system of limited companies should cease to exist, in the way that death occurs under natural selection.

Such concepts cannot be applied to consumers. While a legal person can stop participating in the market, consumers are bound to continue to buy goods and services and to sell their labour on the market. This is why the concept of economic exclusion or elimination and natural selection is not applicable to consumers. A traditional market view of bankruptcy for consumers is impossible. Abandoning the idea of a "debtor's death", the new U.S. American inspired philosophy of fresh start seemed to offer a solution through the "death of the debt".³³

27 Ford, J., cf. footnote 3

28 Hörmann, G., cf. footnote 3

29 Ford, J./Reifner, U. (eds), cf. footnote 3

30 Cf. footnote 3

31 Cf. footnote 3

32 See Table 5: Philosophies on Overindebtedness on p 21

33 See Reifner, U.: 'Thou shalt pay thy debts' - Personal Bankruptcy Law and Inclusive Contract Law, in: Niemi-Kiesilainen, J./Ramsay, I./Whitford, W.C. (eds), Consumer Bankruptcy in Global Perspective, Hart Publishing Portland 2003, p 194-228

But even this idea does not solve the problems of contract law because overindebted consumers remain within the market place where they may conclude contracts and incur debts. They may have better conditions for making a fresh start, but recent developments in the United States, where the number of consumer bankruptcies has attained unforeseen heights, reveal that bankruptcy law merely provides possible compensation. Despite the titles of many corresponding national laws, they do not prevent overindebtedness. If prevention is the most pressing goal of consumer insolvency law, the core field of discussion on consumer bankruptcy should be contract law and its mechanisms for adapting credit extension to the needs of consumers on the one hand and their social risks and abilities to plan and repay their debts on the other.

Formal insolvency law is a necessary tool when it is too late for contractual remedies. Consumer bankruptcy, "fresh start", and "liquidation" do not fit with consumer finance. Instead, "rehabilitation" and "adaptation" underline that the debtor will remain part of the game, continue his relationship with the economy and thus "prolong" contracts in the shadow of the welfare state. The concept of rehabilitation reconciles consumer bankruptcy with social consumer protection in contract law. Just as in *French law*, which until 2003³⁴ did not distinguish between bankruptcy and contract law, there should not be a fundamental difference between insolvency and default, between contractual adaptation and consumer bankruptcy.

Bankruptcy law can therefore be seen as the last step of contract law. The more it buys into the commercial doctrine of liquidation, the more it reflects the failure of contractual remedies and contract law to cope with consumer needs. Socially blind contract Law leads to straight bankruptcy approaches. This is why problems of unstable income should be solved primarily in contract law. Consumer contracts must be adapted to real life and to the income cycles of consumers, just as the entire economy ultimately has to serve the consumer. This can be done only by adapting financial service agreements (loans, savings, and insurance) to consumer needs through specific legislation and a needs-based interpretation of contracts.

34 From 1 January 2004 the new French draft law, granting discharge to all debtors, will come into force.

The *German Federal Constitutional Court*³⁵, deciding on the co-liability of ex-spouses in credit contracts, gave this approach a constitutional foundation. The court asserted that, if the weakness of one party is clear and the solutions offered by the contract are inadequate, "the civil courts must investigate whether the wording of the contract results from a structural imbalance in bargaining power and, if this is the case, rectify the position under civil law through the application of general clauses."

But collective procedures on consumer insolvency and contractual remedies are only alternatives, if contract law is based merely on the idea of free choice while bankruptcy law is centred around the idea of liquidation and social care. The contractual and the bankruptcy approach here are not seen as areas, but also as concepts of law. This means that a contractual approach in bankruptcy regulation is as possible as a social responsibility and care approach in contract law.

Contractual approach (consent, partnership)	
	Bankruptcy Approach (liquidation, care)
Contract Law	Bankruptcy Law

Figure 1: Contract Law and Bankruptcy Law

Continental European consumer insolvency schemes are mostly based on a post-contractual approach. The vast majority opted for a significant repayment period after insolvency has been declared. Many of them have given the option or even the obligation to try out-of-court settlements which at least – in theory – allow suitably adapted contractual solutions for insolvency procedures. They have also introduced assistance mechanisms to compensate for the contractual weakness of overindebted consumers with regard to their and other future creditors.

This law accepts that overindebted consumers have not "failed" or proved unable to participate in a credit society. It assumes that they continue to be consumers but need support and compensa-

35 Bundesverfassungsgericht 1 BVR 696/96 of 02.05.1996, *Neue Juristische Wochenschrift* 1996 p 2021; for a general theory, see *Hippel, E. von*: *Der Schutz des Schwächeren im Recht* [The protection of the weaker party under law], Mohr: Tübingen 1986; for a similar doctrine in Scandinavian law, see *Wilhelmsson, T.*: "Social Force Majeur" - A New Concept in Nordic Consumer Law, *Journal of Consumer Policy* 1993/16 p 435-453.

tion for weakness, but also contains the legal acknowledgement that they are still debtors and thus partners in a contractual relationship. All this contributes to a vision of dignity and respect on which European constitutions are based.³⁶

This is why national contract law is not indifferent towards the social environment which creates overindebtedness and threatens the freedom of contract, nor do European consumer bankruptcy schemes abandon the idea of ongoing contractual relations after a debtor has ceased to honour his debts.

The obligations arising from the original contracts are adapted to the debtor's ability to pay, and are accompanied by the provision of debt counselling and support, assistance for the debtor's family, protection for the debtor's home, and attempts to offer information and education to the debtor.

I.B.2 Informational approach and social consumer protection

Consumer legislation has traditionally followed different models of consumer protection.³⁷ The "liberal model" founded by Adam Smith lies at the root of "homo oeconomicus" as the model consumer.³⁸ Homo oeconomicus has access to full knowledge of his own needs, of all available means of satisfying them, of maximising the use of resources, and he has unlimited scope for processing information. He has no preferences as to brand, time or place and makes decisions without being influenced by people or experiences. In other words, he is perfectly rational.³⁹

This liberal approach does however acknowledge that this homo oeconomicus does not exist in a pure form, because complete information (on grounds of the sheer time and cost required, let

36 See for example art. 1 Universal Declaration of Human Rights: "All human beings are born free and equal in **dignity** and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood."; and art. 1 of the German Constitution: "The **dignity** of human beings is indefeasible."

37 The comments by *Mitropoulos* address this subject in greater depth in: *Mitropoulos, S.*: Verbraucherpolitik in der Marktwirtschaft: Konzeptionen und internationale Erfahrungen, Duncker & Humblot: Berlin 1987, p 4-98; cf. *Hart/Köck*: Zum Stand der Verbraucherrechtsentwicklung, ZRP 1991, p 61 ff (64).

38 Cf. *Kind, S.*: Die Grenzen des Verbraucherschutzes durch Information - aufgezeigt am Teilzeitwohnrechtgesetz [Limits of Consumer Protection through Information], Duncker & Humblot: Berlin 1998, p 42; cf. *Hering, F.-J.*: Informationsbelastung in Entscheidungsprozessen: Experimentaluntersuchung zum Verhalten in komplexen Situationen, Lang: Frankfurt a.M. 1986, p 15; *Leisner*: Der mündige Verbraucher in der Rechtsprechung des EuGH, EuZW 1991, p 498 ff.

39 *Kuhlmann, E.*: Verbraucherpolitik: Grundzüge ihrer Theorie und Praxis, Vahlen: München 1990, p 30; *Kind, S.*: cf. footnote 38, p 43, 44; *Böcker, F.*: Marketing, Lucius: Stuttgart 1996, p 41

alone intellectual capacity⁴⁰) does not exist any more than does spatial independence, because the perfect market upon which the model is based does not exist. It instead forms the basis for a free and responsible model consumer⁴¹, who will digest the information and will then be in a position to take responsible decisions⁴².

Judgments of the European Court of Justice in relation to misleading advertising⁴³ also demonstrate a clear tendency towards this responsible consumer model. This model also underlies European legislation and this is most clearly expressed in the focus of European consumer protection rights on legislation making information provision to the consumer compulsory.⁴⁴

From this perspective, any information improves the position of the consumer, who is thus enabled to come to rational decisions.

On the other hand, the "social" model, in contrast to the liberal model is based on a presumption of the hasty and needy consumer, forced into contractual relations by social circumstances he cannot control, someone lacking in concentration and in need of protection.⁴⁵ According to this approach, it is the duty of the State to protect consumers by controlling the market.⁴⁶

40 *Strassner, S.*: Verbraucherinformationsrecht - rechtliche Grundlagen und rechtsökonomische Aspekte, ÖR.-Verl.: Saarbrücken 1992, p 128 f.

41 *Kind, S.*: cf. footnote 38, p 44; *Dauner-Lieb, B.*: Verbraucherschutz bei verbundenen Geschäften, Wertpapier Mitteilungen 1991 p 144

42 Cf. *Blaurock*: Verbraucherkredit und Verbraucherleitbild in der europäischen Union, JZ 1999 p 801 (802); *Dreher*: Der Verbraucher – Das Phantom in den opera des europäischen und deutschen Rechts?, JZ 1997 p 167 (171); *Heiss, C.*: Formvorschriften als Instrument europäischen Verbraucherschutzes, in: Internationales Verbraucherschutzrecht - Erfahrungen und Entwicklungen in Deutschland, Liechtenstein, Österreich und der Schweiz, Referate und Diskussionsberichte des Kolloquiums zu Ehren von Fritz Reichert-Facilides, Tübingen 1995, p 90; *Mitropoulos, S.*: cf. footnote 37, p 26

43 *Traub*: Das Verbraucherleitbild in rechtsvergleichender Sicht, Baden-Baden 1997, p 19-22 with further examples; ECJ GRUR Int. 1990 p 955; *Blaurock*: cf. footnote 42, p 802; ECJ judgment of 7.3.1990, EuZW 1990 p 222 (224); ECJ judgment of 6.7.1995, EuZW 1995 p 611 (612); *Dreher*: cf. footnote 42, p 171

44 Cf. Verbraucherpolitische Strategie der Europäischen Kommission 2002-2006, 3.3.2.1. and 3.3.2.2; *Blaurock*: cf. footnote 42, p 802 f.; *Dreher*: cf. footnote 42, p 171; *Heiss, C.*: cf. footnote 42; *Mörner*, in: *Cartwright, P.*: Consumer Protection in Financial Services, SMU Institute of International Banking and Finance, Kluwer: Dallas (Texas), Den Haag 1999, p 28; *Wilhelmsson, T.*: Information Duties as a Means of Protecting Insurance Consumers, AJuris 1998 p 71

45 *Traub*: cf. footnote 43, p 31, 32; *Tilman*, in: Festschrift für Henning Piper, Beck: München 1996, p 481; *Hippel*: cf. footnote 35, p 37; *Köck/Hart*: cf. footnote 37, p 63; *Reich, N.*: Schuldrechtliche Informationspflichten gegenüber Endverbrauchern, Neue Juristische Wochenschrift 1978 p 513 (519); *Reich, N./Micklitz, H.-W.*: Verbraucherschutzrecht in der Bundesrepublik Deutschland, Van Nostrand Reinhold: New York 1980, margin note 3; *Reich, N./Tonner, K./Wegener, H.*: Verbraucher und Recht: Überholte Konzeptionen, Lücken und Mängel in wichtigen Verbrauchergesetzen und die Praxis der Rechtsprechung, Schwartz: Göttingen 1976, p 74; BGH GRUR 1991 p 850 (851) and OLG Hamburg GRUR 1992 p 126 - both judgments in relation to

As mentioned above, overindebtedness is often less a chosen situation than a trap in which a system, that on the one hand, cannot guarantee stability of income and sufficient continuous work and on the other hand, requires the continuous repayment of debts, catches especially vulnerable consumers. As empirical research shows, overindebtedness frequently leads to social exclusion through restricted opportunities⁴⁷, higher fees and higher rates of interest⁴⁸. It is therefore primarily not attributed to a lack of knowledge about the product but to unstable income⁴⁹ caused by unemployment⁵⁰, illness, divorce, sudden death⁵¹ and – to a lesser degree – also to a false use of credit facilities.⁵² Money advice centres claim⁵³ that the main causes are subsequent unforeseen events.

Strict rules in contract law, which would limit the freedom of contract for suppliers, force them to limit contractual interest rates, reduce costs in default, refrain from credit cancellation in difficult social situations and regulate certain types of combined credit which is especially dangerous for people with high risks. In short,

misleading advertising; *Baumbach/Hefermehl*: Wettbewerbsrecht, 8th edn. 1995, art. 3 UWG margin note 33

- 46 *Reich, N./Tonner, K./Wegener, H.*: l.c., preface, p I; *Bartsch*, ZRP 1973 p 13 ff; *Reich, N./Micklitz, H.W.*: l.c., margin note 5; *Damm*, JZ 1978 p. 173 (179); *Köck/Hart*: cf. footnote 37, p 63; *Biervert, B./Fischer-Winkelmann, W.F./Rock, R.*: Grundlagen der Verbraucherpolitik, Rowohlt: Reinbeck 1977, p 178.
- 47 *Hoes, V.*: Die Überschuldung Privater als Problem von Ungleichgewicht, Lang: Frankfurt a.M. 1997, p 22
- 48 *Observatoire du Crédit et de l'Endettement*: La Consommation et le Crédit aux particuliers, p. 162
- 49 *Korczak, D./Pfefferkorn, G.*: cf. footnote 3, p 274 f; *Adler*: The Economic and Social Situation of Consumer Debtors in Great Britain, in: *Hörmann, G.*: cf. footnote 3, p. 54, 58; *Zimmermann, G.E.*: Überschuldung privater Haushalte - empirische Analysen und Ergebnisse für die alten Bundesländer, Lambertus: Freiburg i.B. 2000, p 152 f; *Betti, G./Dourmashkin, N./Rossi, M.C./Verma, V./Yin, Y.*: c.f. footnote 4 (http://europa.eu.int/comm/consumers/cons_int/fina_serv/cons_directive/fin_a_serv06_en.pdf)
- 50 *Huls, N.*, et al.: cf. footnote 1, p 63; *Korczak, D./Pfefferkorn, G.*: footnote 3, p 274; Lebenslagen in Deutschland, Erster Armuts- und Reichtumsbericht der Bundesregierung, BT-Drucksache 14/5990, p 65; *Kempson, E.*: Understanding the Problem of Debt – The British Context, in: Consumer Debt in Europe – The Birmingham Declaration: Proceedings of the Third European Conference on Overindebtedness, Birmingham, 4 and 5 December 1992, p 24; *Ford, J./Morin/ Martin/Dejemeppe, P./Reifner, U./Bourgoignie, T.*: Verschuldung, Armut und Arbeitslosigkeit in Europa, in: *Reifner, U./Reis, C.* (ed): Überschuldung und Hilfen für überschuldete Haushalte in Europa, p 20
- 51 *Korczak, D./Pfefferkorn, G.*: cf. footnote footnote 3, p 275; Erster Armuts- und Reichtumsbericht der Bundesregierung, BT-Drucksache 14/5990, p 65
- 52 *IFF*: Schuldenreport 1999 – Kredite der privaten Haushalte in Deutschland, Nomos: Baden-Baden 1998; Erster Armuts- und Reichtumsbericht der Bundesregierung, BT-Drucksache 14/5990; *Reifner, U./Reis, C.*: cf. footnote 50; *Observatoire du Crédit et de l'Endettement*: Crédit, Endettement et Surendettement des Ménages en Europe; *Kempson, E.*: cf. footnote 50; *Betti, G./Dourmashkin, N./Rossi, M.C./Verma, V./Yin, Y.*: c.f. footnote 4
- 53 *IFF*: Schuldenreport 1999, l.c., p 24 f

social consumer protection rules could be the only effective solution for preventive regulation of overindebtedness.

But from a supplier's perspective, social consumer protection may not only help consumers to survive in a crisis. The costs incurred through such legislation would have to be shifted to those consumers who do not fail. In a competitive environment this may provide incentives for excluding the most vulnerable consumers from credit at all. People without debts may then be even worse off than the overindebted because they are totally excluded.

But such arguments against any social consumer protection legislation do not hold true in the light of empirical evidence. Countries with a high degree of banking supervision, regulated rate ceilings and harsh restrictions on usury, debt collection and intermediaries⁵⁴ seem to have a much lower rate of exclusion than countries which follow a more liberal approach⁵⁵. The rational choice doctrine argues that attributing losses not only to those who are responsible for them will cause higher exclusion rates. This argument ignores the importance of a newly emerging factor in economic theory: trust. General trust among consumers and suppliers in the economy and its mechanisms will provide a significant amount of security and allow a much greater variety of products and mechanisms. Adverse selection and moral hazard may create high transaction costs, especially with those who do not expect any consideration for their fate from the system.

This is why keeping overindebted people integrated into the productive parts of society may be less costly than focussing only on those who are sufficiently creditworthy. Such policy will create a feeling of protection and care, which in turn provides a higher level of consumer trust within the economy. Vulnerable consumers who feel that, even in difficult situations, the credit society will care for their problems are more reluctant to misuse the system or wilfully withhold payments than consumers who are aware of the fact that, if they fail, the system will actually increase their financial burden. In a credit system which creates trust wealthier consumers will also develop a sense of solidarity and not only be more honest themselves but also be more inclined to carry those burdens which

54 See *Domont-Naert, F./Dejemeppe, P.*: Etude sur le Rôle et les Activités des Intermédiaires de Crédit aux Consommateurs, Contrat No. AO-2600/95/000254, 1996

55 For a harsh critique of the lack of effective usury legislation in the UK, see *Palmer, H./Conaty, P.*: Profiting from Poverty - Why Debt is Big Business in Britain, New Economics Foundation London 2002, p 40 f. See also the reports of the IFF-2000 Gothenburg conference on "Access to Financial Services" (<http://www.iff-hamburg.de/4/goeteburg.html>)

are inflicted by the small group of overindebted persons who defaulted.

But the necessity for social consumer protection does not call into question the preference for informational approaches. In dubio pro libertate is the legal principle of contract law and should be applied wherever there is any query as to why overindebtedness occurred.

Informational and social approaches in consumer protection are therefore complementary, in the same way as bankruptcy law and contract Law. Social consumer protection can provide sufficient choices for the contracting parties and may offer opportunities for autonomous decisions. On the other hand, consumer information may, in particular, address social risks and facilitate the evaluation of the effects of a credit contract when such risks occur.

Obligations to provide information must take into account that the mere availability is not enough.⁵⁶ Financially sane decisions presuppose above all the capacity to make transactions in relation to the actual social and financial situation.⁵⁷ To that end, the first requirement is that consumers make use of the available information.⁵⁸ The consumer's own response is a pre-condition for this. However, the manner and scope of responses relating to information depend on a number of factors⁵⁹, not all of which can be affected by information, but which instead adapt such information. This must be taken into account in order for it to have any effect.⁶⁰ The main influences are as follows:

- Characteristics of the information materials made available to the consumer, such as content and completeness of the information, its form, and acceptance of the source of the information.

56 *Breidenbach*: Die Voraussetzungen von Informationspflichten beim Vertragschluss, p 11; *Kemper, R.*: Verbraucherschutzinstrumente, Nomos: Baden-Baden 1994, p 205

57 *Reifner, U.*: Finanzielle Allgemeinbildung – Bildung als Mittel der Armutsprävention in der Kreditgesellschaft, Nomos: Baden-Baden 2003, p 76. On the concept of capacity, see *Boetz/Hartmann*: Kompetenzentwicklung statt Weiterbildung?, <http://www.die-frankfurt.de/Zeitschrift/497/thema.htm>

58 *Kemper, R.*: cf. footnote 56, p 218

59 Cf. *Simitis, K.*: Verbraucherschutz. Schlagwort oder Rechtsprinzip?, Nomos: Baden-Baden 1976, p 111; *Biervert, B./Fischer-Winkelmann, W.F./Rock, R.*: cf. footnote 46, p 177, 178

60 Cf. *Biervert, B./Fischer-Winkelmann, W.F./Rock, R.*: cf. footnote 46, p 177; *Whitford, W.C.*: The Functions of Disclosure Regulation in Consumer Transactions, Institute for Research on Poverty, University of Wisconsin-Madison 1973, p 220 (239)

- Personal characteristics and attitude of the consumer, e.g. general level of education⁶¹, basic knowledge about the product⁶², needs.
- External circumstances surrounding distribution of the information, including the manner of distribution of the information and the time when the information was distributed.

Only informational rights which take all of these aspects into account can affect the consumer's decision and prevent overindebtedness. They are complementary and, to some extent, conflict with each other. For example, objectively complete information is not necessarily the best in terms of what consumers are capable of absorbing. It may therefore be advisable in some circumstances to avoid completeness in favour of enabling consumers better to process the information overall and to focus on the aspects significant for the decision to be made.

I.B.2.a) Contract Law and Overindebtedness

Contract law mirrors in itself the contradiction between rational choice (informational consumer protection) and social care (social consumer protection).

The rational consumer is presupposed in the principle of freedom of contract and supported by a high degree of information as a basic consumer right. But after the conclusion of the contract, the binding contract, according to the principle of *pacta sunt servanda*, reduces the freedom of the parties in accordance with the rules by which they have agreed to abide. Contract law is therefore to that extent a complementary system of freedom and coercion.

The coercion expressed in the right to enforce one's own rights with state support, which may even result in the execution of force (wage garnishment, seizure of property, repossession), is deemed to be justified by the previous consent of the parties. A debtor who has agreed to a credit contract is obliged to repay the debt and honour this agreement. If unforeseen events hinder the fulfilment of the obligations or if the debtor has miscalculated his ability to repay, the most appropriate remedy to such problems would be an improved process of search and contracting.

61 *Simitis, K.*: cf. footnote 59, p 111; *Biervert, B./Fischer-Winkelmann, W.F./Rock, R.*: cf. footnote 46, p 155

62 *Vahrenkamp, K.*: *Verbraucherschutz bei asymmetrischer Information: informationsökonomische Analysen verbraucherpoltischer Maßnahmen*, VVF: München 1991, p 37

Information, education and advice could therefore be seen as the most appropriate measures in the market society to cope with the phenomenon of overindebtedness.

Contract law has therefore to decide to what extent informational rights can help to cope with overindebtedness.

If, as some would argue, overindebtedness is an addiction to credit, education and information would be the only preventive measure. Groups of "Anonymous debtors"⁶³ such as groups of "Anonymous alcoholics" or cigarette smokers already exist in the United States. A direct way to prevent consumers from overindebtedness would therefore be a warning to the borrower before the loan is taken out, rather like the warnings given on cigarette packages. Such warnings do exist. Before loans are granted, consumers are informed that they have the right to reflect during the cooling-off period. This should prevent hasty decisions to take out loans. But this can work only if borrowing as such⁶⁴ is the problem, just as smokers or alcoholics are advised to refrain from the use of such drugs in general.

For the vast majority of debtors this is not the case. Credit is a necessary service in modern society just as cars or mobile phones are. Their use may cause problems and accidents but no more than other basic necessity services, such as electricity or water supply. Nobody would advise rejecting electricity simply because there are fatal accidents resulting from the way it is used. A general discouragement from entering into a credit agreement is neither appropriate nor even desirable. In a modern credit society it is often advantageous to take out a loan, for example to finance the purchase of a car needed for transport to work, or to fund a course of studies for further training. Borrowing is therefore a common transaction.⁶⁵

A clear distinction must therefore be drawn between indebtedness as the logical result of borrowing in the modern credit society⁶⁶, and overindebtedness which is associated with financial hardship, where the debtor is no longer in a position to meet the loan re-

63 See <http://www.debtorsanonymous.org>: "Debtors Anonymous is a fellowship of men and women who share their experience, strength and hope with each other that they may solve their common problems and help others to recover from compulsive debting."

64 *Graf v. Westphalen, E./von Rottenburg*: Verbraucherkreditgesetz, art. 4 margin no. 2

65 Cf. *Korczak, D./Pfefferkorn, G.*: cf. footnote 3, p 274

66 *Korczak, D./Pfefferkorn, G.*: l.c.; Erster Armuts- und Reichtumsbericht der Bundesregierung, BT-Drucksache 14/5990, p 63; *Zimmermann, G.E.*: cf. footnote 49, p 6; *G./Dourmashkin, N./Rossi, M.C./Verma, V./Yin, Y.*: c.f. footnote 4, p 1

payments.⁶⁷ For that reason, a mere warning such as that on cigarettes and alcohol would be no solution in financial services. Information duties should therefore not caution against credit but against the elements leading to overindebtedness. It is the personal circumstances of the borrower and the design of the product which make credit dangerous. Warnings would therefore have to integrate personal information into the description of the effects of the product and thus narrow the gap between provider and consumer.⁶⁸

As the most rights to information apply before or at the time of signing a credit agreement, they are incapable of directly combating overindebtedness in such circumstances. They do, however, become relevant when, in situations of overindebtedness, debts are rescheduled, and they accordingly have some significance in relation to this "passive indebtedness". One could therefore argue that consumer information is by no means adequate in combating overindebtedness.

But the distinction between inescapable objective reasons and those subjective factors which could be influenced through information is not truly helpful. A Canadian research study⁶⁹ focussed on groups similarly affected by the same objective factors of unstable income, such as unemployment or illness. But only a minority of those affected became insolvent, while the majority was able to recover and adjust their commitments to their actual income. Attitudes, knowledge, and education therefore play not only an important role in the choice of financial services but also in how such crises can be managed or prepared.

Problems in terms of housekeeping⁷⁰, consumer behaviour⁷¹, even outright lack of education, inexperience or gullibility⁷² in credit

67 Korczak, D./Pfefferkorn, G.: l.c.; Hoes, V.: cf. footnote 47, p 23; *Observatoire du Cr dit et de l'Endettement: La consommation et le cr dit aux particuliers*, p.. 162; Betti, G./Dourmashkin, N./Rossi, M.C./Verma, V./Yin, Y.: c.f. footnote 4, p 2

68 Cf. Vahrenkamp, K.: cf. footnote 62, p 20 f; Kuhlmann, E.: *Verbraucherpolitik: Grundz ge ihrer Theorie und Praxis*, Vahlen: M nchen 1990, p 85; Lauer: *Vorvertragliche Informationspflichten*, p 14 f; Kemper, R.: cf. footnote 56, p 176 f, 185, 187; Biervert, B./Fischer-Winkelmann, W.F./Rock, R.: cf. footnote 46, p 135; Grimm, A.: *Das neue Verbraucherkreditgesetz*, p 454; Whitford, W.C.: cf. footnote 60, p 201

69 Duhaime, G.: cf. footnote 3

70 Korczak, D./Pfefferkorn, G.: cf. footnote 3, p 275; Kempson, E.: cf. footnote 70, p 24; Zimmermann, G.E.: cf. footnote 49, p 152 f; Creemers: *The Problem of Indebtedness and Assistance to the Indebted in the Netherlands*, in: *L'Observatoire du Cr dit et de l'Endettement* (ed): *Cr dit: Endettement et Surendettement des M nages en Europe*, p 216; Lowe, R./Woodroffe, G./Gerlis, S.: *Consumer Law and Practice*, Sweet Maxwell: London 1999, p 327

71 IFF: *Schuldenreport 1999*, cf. footnote 52, p 37; Zimmermann, G.E.: cf. footnote 49, p 152 f; Creemers: l.c.; Lowe, R./Woodroffe, G./Gerlis, S.: l.c.

commitments involve pitfalls already present at the time the agreement is concluded⁷³. Some overindebted consumers lose track of their finances because of new methods of payment, such as credit cards and cash-free payments using mobile phones or the Internet⁷⁴; others do not. Contract law can supply the necessary information but also the necessary restrictions for suppliers of products and services with potential pitfalls.

I.B.2.b) Debt Collection and Debt Enforcement

The role of information in the collection of debts and enforcement of judgments is currently undergoing dramatic change. The focus of debt collection was historically on tangible property, and during the modern period it shifted over to financial assets, which in the case of non-business debtors means their salaries or other regular income. The most recent shift in debt collection has been towards the collection and understanding of information about the debtors and their assets. Information and control over information has always played a crucial role in debt collection, but the role and type of information has changed as the focus of debt collection has changed.

Debt collection and the enforcement of judgments are inherently creditor protective and the creditors' point of view has been dominant in the regulations. The debtor protection perspective has been introduced to the law on enforcement of payment judgments through two kinds of regulations, (1) by regulating what property the debtor is allowed to keep in enforcement (exemptions), and (2) by regulating what portion of income is protected against garnishment (about debtor protection in garnishment see subchapter II.C.3). The traditional information problem in both informal and judicial debt enforcement has been the location of the debtor's assets and source of income. While the debtor has had an advantage as he has had control over this information, information gathering by the enforcement agencies has focused on the debtor, his place and immediate surroundings.

Today this kind of information is of limited value. Consumer debtor's tangible assets in particular have as a rule practically no value over the costs of collection, storage and forced sale required by enforcement regulation. In small business cases, the value of

72 Korczak, D./Pfefferkorn, G.: cf. footnote 3, p 275; Kempson, E.: cf. footnote 70, p 24; Bourgoignie, T., in: Domont-Naert, F.: *Consommateurs défavorisés - Crédit et Endettement*, Préface; *Observatoire du Crédit et de l'Endettement: La Consommation et le Crédit aux particuliers*, p 162

73 Hoes, V.: cf. footnote 47, p 25

74 Erster Armuts- und Reichtumsbericht der Bundesregierung, BT-Drucksache 14/5990, p 65; *Observatoire du Crédit et de l'Endettement: l.c.*, p 158

assets is nowadays also often minimal, but for somewhat different reasons; the tangible property (computers, other electronic equipment, machinery, cars etc.) is usually leased or otherwise pledged as security.

The first shift in debt collection and enforcement meant that focus shifted to bank accounts, cash flows and, for consumers, to regular salaries and wages. When wage garnishment became an electronic operation, the efficiency of garnishment increased tremendously.

Today, debt collection technologies focus on a different kind of information. We can distinguish two developments in economic life which are of relevance here. Firstly, the financial market operates in an electronic world today and as it is a global market, financial assets can move rapidly worldwide. Economic values are no longer locally tied. These developments change the role of information in debt collection. In particular, access to electronic data becomes crucial. Financial assets can be recovered only electronically and with the help of financial institutions. Quick action is necessary.

Secondly, the labour market has shifted from one which favoured permanent or long-term working relations to one in which employees are changing from one short-term employment to another or are working in several part-time jobs simultaneously, blurring the distinction between self-employed and minor businesses.

With several or changing employers or contractors, wage garnishment becomes less and less feasible. Instead, debt collection has started to focus on general information about the debtor, especially his financial activities.

All Member States have highly advanced credit information systems, which are run either by the central banks or large private companies. These systems started by collecting information about payment default. Today the big discussion is about whether such credit information registers should also include so called "positive information", namely information about debtors and loans that have never been in default.

Another important development is the introduction of electronic information to the debt enforcement agencies. These sometimes quite old-fashioned, bureaucratic and inefficient agencies have access to various sources of information which, if put to effective use, can change the nature of debt enforcement dramatically. There are several data protection issues that need to be discussed and solved in the future, such as to the kind of information to which debt enforcement agencies should have access, which in-

formation and for how long they are allowed to keep it on their registers.

Information about the debtor is more varied than it used to be; instead of tangible assets and steady employment, debtors may have several sources of income and different financial investments or interests. This kind of information is combined with information about default and assets. Debt collection agents are now developing different tools to master this flow of information. Various credit rating systems are in use. Data protection problems related to this kind of activity are completely new. The debtor is no longer able to check the correctness of the information, since he cannot know how the rating system works and whether it is fair and non-discriminatory.

To summarize, the transformation from a monetary economy to an economy based on information technology has changed the role of information in debt collection and enforcement in a dramatic way. In this subchapter, it is only possible to distinguish only some most of the most relevant trends in the development. It is clear that this transformation is going to have an enormous impact on the need for regulation of debt collection, debt enforcement, access to information, data protection, protection of privacy etc. The discussion on these issues has hardly begun. It seems clear that since information flows freely across borders, the matter is of legitimate concern for the European Union.

I.B.2.c) In Insolvency Law

In consumer insolvency law the informational element can be viewed from two perspectives. Firstly, in consumer insolvency law the core issue can be conceptualized as the allocation of risk. This is the common approach in law and economics based on research and policy discussions. Secondly, from a quite different perspective, the financial literacy approach has started to consider consumer overindebtedness as an educational and information problem.

I.B.2.c)(1) Information and Risk

In the law and economics approach, several principles of risk allocation have been developed. A crucial factor is asymmetric information. According to law and economics principles, the risk would usually be allocated to the party who has the knowledge and opportunity of taking precautions to prevent the risk from materializing. The common assumption is that the debtor has the best information about his situation and is therefore in the best position to avoid the risk of overindebtedness. This is, of course, in many respects quite true. If the risk of overindebtedness is totally

shifted to the creditor, a serious problem of “moral hazard”, that is, debtors who deliberately avoid their obligations, can arise.

The risk society theories claim that the individualistic approach towards risk, referred to above, is inadequate for assessing the risks in post-modern society. Indeed, many contemporary risks, such as unemployment and lay-offs, are not individual in their nature. Information about them is not available on an individual basis. Even when we are talking about more individual risks of, for example, illness, accidents and family disruptions, the information about their likelihood is probability-based and statistical. Their assessment at an individual level is neither possible nor appropriate. Clearly, institutional credit institutions are in a better position than individual debtors to make calculations about risks that are connected to general economic development or that are statistical in nature.

The credit industry has developed advanced credit risk assessment systems. Whatever the operational basis, two things are crucial in the context of consumer insolvency. Firstly, commercial lending is based on maximizing profit, not on minimizing risk. Maximum profit typically requires that a certain level of risks materializes. Secondly, a risk has materialized when the debtor can not pay (and the creditor can not realize a security). Whether the non-payment results in discharge of debt in legal or other proceedings is of secondary importance.

On informational grounds the allocation of risk of overindebtedness should be guided by two principles, namely, taking into account the different modes of information the institutional lenders and individual debtors have. The more advanced information technologies of the creditors need to be balanced against the risk of moral hazard from the debtor’s side. In an ideal world, statistical risks would be allocated to institutional creditors and risks related to “moral hazard” type of borrowing behaviour to debtors.

This aspect alone is not, however, sufficient to guide legal policy on overindebtedness, not even within the law and economics paradigm on which the discussion on information has been based in this subchapter. The law and economics theory takes into account the capacity to bear the risk. In this assessment, institutional lenders are superior risk bearers as compared to the consumer debtor. In particular, they have the opportunity to spread the risk among the borrowers. In addition, law and economic theory requires that all costs caused by a certain activity should be calculated as costs and, if possible, also borne by the actors. Now, the costs of overindebtedness are caused by lending, but to a large extent borne by the public sector. Overindebtedness causes



health problems, need of social security contributions and exclusion, which may lead to serious social problems concerning the debtor and his children. Most of these problems cause costs that are in the European welfare states borne by state, communities and other public bodies (see subchapter I.C.2.b) below). This study does not use the theoretical framework of law and economics, but as indicated above, reasonable risk allocation is supported also from this theoretical point of view.

This study is of the opinion, however, that the legal policy has to have a moral regard to the debtors' living conditions. As was noted above, profitable commercial lending necessarily causes a number of overindebted consumers. Therefore, all excessive borrowing behaviour can not be regarded as "moral hazard". The general policy must be to ensure that the debtor's situation does not become unbearable.

I.B.2.c)(2) Financial Literacy

The financial literacy approach takes a different view of the informational problems in consumer insolvency. It is a general claim that many debtors run into troubles because their financial skills are not sufficient for the contemporary credit society. The financial literacy approach advocates financial education at various levels. The consumer insolvency context is seen as an appropriate forum for improving financial literacy.

The concepts in this field have not been properly developed.⁷⁵ A useful distinction can be made between individual counselling and group education. This differentiation is comparatively useful since European countries have usually emphasized the need for individual counselling before the debtor files for consumer insolvency proceedings. The idea is that the counsellor should help the debtor to find ways of coping with the debt situation and that the debtor should get advice on different strategies to resolve the situation, beginning with a change in consumption patterns, household budget management and finally moving on legal measures. In practice, however, counsellors have a heavy case load and the counselling tends to focus on the most straight-forward procedures. Where the country has a consumer insolvency law, the counselling is often little more than para-legal help in preparation for filing for insolvency proceedings.⁷⁶

In contrast, in Anglo-Saxon countries, the debtor usually contacts a professional legal practitioner before filing for consumer bank-

⁷⁵ For more details see II.E.3

⁷⁶ For more details see II.E.1

ruptcy. Recently, many writers have pointed out that a narrow legal approach is unable to address the problems that caused the overindebtedness in the first place. Therefore, financial literacy education has been offered in response to this problem. In Canada all consumer bankruptcy debtors are required to participate in two sessions of financial education. In the United States, several programmes are at an experimental stage.⁷⁷ All these programmes are based on group education.

There has been some criticism of financial education in the consumer bankruptcy context. Its effects have not been proved scientifically. It is also argued that bankruptcy is not the appropriate time for such education. It would certainly be better if everyone could learn the necessary skills in high school. For as long as this is not the case, the financial literacy approach has to be taken seriously.

It is important to keep the difference clear between acute, case related counselling and a more general educational approach, namely, financial literacy programmes. Financial literacy programmes should not be used to reduce the legal and other advice offered to overindebted consumers who seek relief. Debtors should undoubtedly have an opportunity to improve their coping strategies in the long run.

I.B.3 Informal and legal procedures: the preference for legal procedures?

Overindebtedness is traditionally be dealt with in two separate spheres. Lawyers define it as part of the law of executions, while debt counsellors see it as a social problem. The gap between the legal and the social sphere has to be bridged. The most effective approach is a combination of the two: overindebtedness should be dealt with as far as possible by professional and independent debt counsellors, while the law should facilitate and strengthen voluntarily negotiated debt settlements.

Debt issues should be kept outside the courts as far as possible. Professional debt counselling should play a vital role here. An appropriate approach to the financial problems of private persons requires skills that lawyers do not acquire in the course of their education. Furthermore, the economic stake, that is, the amount the debtor is able to pay back in the best of the circumstances, is

77 Especially the project „Coalition for Consumer Bankruptcy Debtor Education“ in New York. For more details, see: *Block-Lieb, S./Gross, K./Wiener, R.L.: Lessons from the Trenches: Debtor Education in Theory and Practice*, in: *Fordham Journal of Corporate & Financial Law*, Volume VII/No 2, 2002, p 503-523

usually too small to justify calling in attorneys at commercial hourly rates.

The judiciary must be relieved from numerous individual proceedings, attachments and the like, which at present are often litigated at the same time against diverse creditors whose individual claims cannot be satisfied due to the insolvency situation.

Experience shows that despite all the attempts legislators have made to regulate the individual credit behaviour of banks and consumers, the emergence of overindebtedness could not be prevented. In order to respond adequately to this problem, it is necessary to broaden the scope.

In the first place, it is essential to shift from an individual to a collective approach. A consumer in financial trouble hardly ever has only one creditor. The general rule is that an overindebted consumer has many creditors who all want to get paid. Therefore, the problem of multiple debts must be addressed. The troubled relationships between one debtor and his many creditors cannot be dealt with adequately on an individual basis. Thinking about debt settlement means thinking in terms of all the creditors.

Furthermore, the scope should be broadened to other debts apart from credit. Typically, an overindebted consumer also has housing, tax, utility debts and the like. For a really effective approach to the problem, one cannot restrict solutions to credit alone. All debts have to be covered.

It is clear that some form of legal backing is required. Often a voluntary solution is frustrated by one creditor. Because the other creditors want to take part in an arrangement only if all the creditors are included, debt counsellors have to have leverage to persuade unwilling creditors into the agreement.

In the institutional framework in the *1994-Overindebtedness study* voluntary workouts were negotiated "in the shadow of the law". There, a two-tier system was proposed in which the debt counsellor formulates proposals for repayment plans on the basis of the principles described in the law. An objective and expert analysis must be made of the debt position and the redemption capacity of the debtor, so that a realistic plan can be proposed. If the creditors agree, the proposal should be given the binding force of an agreement. If a voluntary agreement cannot be reached, the debt counsellor sends his proposal to the judge, who decides. In this second tier, the judge acts as a decision-maker in contested cases.

In addition, nowadays informal procedures are favoured. But it is only fair to note that creditors often prefer a formal procedure via

the court if they have the choice. The introduction of a new legal possibility in the law leads many creditors to evaluate the pros and cons of both formal and informal debt settlements. It should, however, be noted that there is no such thing as “the creditor”. For instance, utility companies and landlords who cannot simply cease all contacts with a debtor, take a different approach to that taken by banks or mail order houses. Government creditors bound by statutory provisions with regard to their scope for agreeing to claims are in a different position to creditors who can agree to what they want themselves. Having said this, the following are reasons as to, why creditors prefer statutory debt settlements to voluntary ones.

Some creditors think that statutory debt settlements are more beneficial to them than voluntary ones because the former leads to larger financial return. As a rule, the voluntary procedure does not relate to the execution of property, the debtor's house in particular.

Furthermore, supervision of the debtor is often stricter under the legal procedure. The trustee is an officer of the court, while the social worker in the debt counsellor's office is perceived by creditors as an advocate of the debtor. Creditors put more trust in the legal procedure because of its greater objectivity. In law and economics literature, this is called information asymmetry. In order to decide whether he will write off his claim, the creditor needs reliable information. Court-related information is better in this respect than information gathered via informal procedures.

Furthermore, some major creditors allow their local branches to write off claims only if this is ordered by the court. If a creditor says “no” to a voluntary proposal, it is often cheaper for him, because he no longer needs staff to do the bargaining with the debt counsellor and the other creditors. If there is a statutory procedure, monitoring by the trustee is often paid for by the state and the creditors pay nothing.

A further gain for the creditor lies in the fear for recidivism. If a creditor agrees to a voluntary debt settlement, a debtor can request another one a few years later. If creditors do not wish to participate in a second voluntary debt settlement, the debtor can apply for a statutory debt settlement. Once this is over, a debtor cannot request a new statutory debt settlement for the next ten or more years. By not agreeing to a voluntary debt settlement, a creditor is assured that, in the ten years after the statutory debt settlement, it need not write off a claim again.

Another factor is the debtor's feeling of guilt and shame. A legal procedure involves publicity. The name of the debtor is in a daily newspaper and in a public register. Some debtors are ashamed of being in debt, and unwilling to have their name made public. Some creditors refuse to participate in a voluntary debt settlement because they "speculate" on this feeling of shame of their clients.

Some creditors perceive a statutory debt settlement as being more "punitive" for the debtor than a voluntary one. Sometimes small creditors who know the debtor personally use this eye-to-eye argument.

It is wise to recognise such creditor preferences, because in a way they are the main players in the field of credit and debt.

I.C What are the Evaluation Criteria?

I.C.1 Means of Prevention

It is easy to agree that prevention of overindebtedness is preferable to corrective means when the consumer is already hopelessly indebted. The usual argument for prevention assumes that considerable losses on the creditor's side can be avoided as long as debtors take out only the amount of credit that they can pay back. From *institutional creditors' point of view*, the profit calculation is not that simple, as was indicated above in subchapter I.B.2.c)(1). The fact is that institutional creditors, who aim at maximizing their profits, calculate that certain risk-taking is profitable, and thus a portion of their debtors turn into risks.

From *consumer debtors' point of view*, prevention is almost always a better alternative. The process of becoming overindebted usually entails a great deal of distress. Debt problems underline other related problems, such as unemployment or illness, and often property, which is of much greater value to the debtor than to any prospective buyer, gets lost through voluntary and involuntary sale.

While it is easy to agree on the benevolence of prevention, it is more difficult to say what the best policy to prevent overindebtedness would be. We can take for granted that a return to the regulation of credit interests is not an option. In addition, it has to be pointed out that adequate social and health policies are a necessary part of meaningful strategies to prevent overindebtedness. An example can be seen in family policies. Divorce plays a major role in payment incidences and insolvency. But it may not be divorce as such, which plays this role, but the way it is regulated in the national legal system. In some countries the procedural costs are high and major tax advantages are abruptly discontinued making a liquidity crisis inevitable. Such policies, which can cope with

these circumstances, however, fall out of the scope of this study. Instead, the study aims to consider the relationship between consumer credit practices and overindebtedness.

It seems clear that not even the best credit practices can completely prevent overindebtedness. But when becoming overindebted is viewed as a process, several stages can be distinguished in this process, in which legal provisions are of considerable importance.

Firstly, even in the absence of credit interest regulation, consumer credit legislation has an important effect on how and under what conditions consumers are indebted. Consumer credit legislation regulates the contract terms on transparency, that is, information given to the debtor both at the time of concluding the contract and during the contract. Also, the terms of cancellation of a consumer credit contract are regulated.

Secondly, modern technologies have made it possible to collect vast amounts of information on debtors. This information can be the most effective means of preventing overindebtedness. Several issues related to positive credit information, data protection and the consequences of a creditor's failure to use available information are highly controversial issues at the moment.

Thirdly, it is widely acknowledged that one of the most dramatic ways in which consumers become seriously overindebted is the practice of taking personal guarantees for loans from persons close to the debtor. The guarantors may be spouses, other family members, close relatives, sometimes friends or employees. The loans guaranteed vary from small business loans to consumer credit. Typically, the closeness between the debtor and the guarantor make it difficult for the guarantor to refuse to sign the contract.

Fourthly, debt collection practices, both informal out-of-court debt collection and judicial debt collection through the courts or other official agencies, often affect the process of overindebtedness. Since the contract terms normally allow the creditor to enforce the whole amount of the credit in case of default, the debt collection of one credit often has a devastating effect on the whole economy of the debtor.

Since the above-mentioned factors are considered essential to the process of overindebtedness, information about them in the Member States will be presented, and their effect on overindebtedness will be discussed in chapter II.A below.

I.C.2 Integration or Exclusion

I.C.2.a) Credit and Debt

Most experts agree that the primary - but not the only - cause of overindebtedness is credit. Everywhere in Europe, overindebtedness is now more widespread than several years ago. For various reasons, many consumers are not able to pay back their debts. Such financial entrapment can happen to almost any credit user.

Four different groups of overcommitted debtors can be distinguished. The first group is the group that runs into temporary misfortune (i.e. unemployment, divorce, illness, and so on). A second group consists of people who unconsciously become overcommitted. This group makes use of the widely available forms of credit, without realising that they might not be able to repay in the future. The third group are the "poor" who have to take credit in order to attain a reasonable standard of living. The fourth group covers both people that wilfully overcommit themselves financially and people that attempt to defraud their creditors.

Overindebtedness in most European countries is associated with failure and bankruptcy. The term bankruptcy has stigmatic connotations as it puts the blame on the debtor. Bankruptcy is degrading and can reduce one's self-esteem a feeling reinforced by the disapproval of others.

The idea that insolvent people should be taught a lesson which they won't forget, does not fit with an economic approach towards overindebtedness. The penal approach towards debtors is not a good thing from a policy perspective because it leads to the exclusion of some categories of consumers. People that are deeply in debt should not be treated as sinners or criminals. The idea that a debtor should suffer for the rest of his life because he becomes overindebted, is not acceptable anymore in a credit society that promotes the take up of credit and positively values risk-taking in financial matters.

Failure is as much a part of the market-process as is success. A certain amount of failure is taken into account by the creditors beforehand. Thus, for the creditor default is a routine part of the cost of granting credit. A society that accepts credit offered by the market should also accept overindebtedness as an inherent side effect. The fact that there are casualties shows that the market is working, because profit and loss are indissolubly linked with competitive market processes, and winners as well as losers are an outcome. Both categories should be seen as part of the financial system.

Insolvent people should not be treated as guilty until proven innocent, especially when the real reasons for such consumers becoming overindebted are accepted. Today, people get into financial difficulty for numerous external causes, including unemployment, divorce or collapsing real estate prices (group 1). Apart from this, people can get into trouble through poor financial management, overestimation of their redemption possibilities, or too high a desire for material prosperity (group 2). It has also been suggested that many families run into difficulties because of Government policies aimed at pushing back the welfare state and social sector. In several European countries, a shift is indeed taking place in several areas from public to private financing, which has consequences in the private sector. Public attention is often concentrated on the consequences of those changes for the lowest income groups, but the contraction of the public sector affects middle and higher income groups as well.

I.C.2.b) Overindebtedness: A Societal Problem

The social and psychological consequences of overindebtedness are often very far reaching. Repayment problems can have a destructive effect on family-life. Social and psychological disturbances can result, which can manifest in escapism or a complete withdrawal from societal life because of feelings of shame.

Because the legal position of insolvent people is weak, they are vulnerable to threats and harassment from their creditors and debt collection agencies. The actual number of evictions, disconnections and so on is relatively low, but the expectation of their execution may be felt as a sword of Damocles. Despair and insecurity result because debtors do not have any prospect of building up a new life.

A special group of debtors who have a high risk of running into trouble are the self-employed. They are more exposed to the risks of economic life than wage-earners. The self-employed are often able to get enough capital for their business only by the waiver of limited liability. In most countries in Europe, small business people are normally individually liable for their business debts. Going bankrupt is especially painful for this group because they not only lose their business, but are personally bankrupted as well.

In many EU Member States, the state provides a minimum standard of living to its inhabitants. This means that indirectly the state often has to carry the losses resulting from overindebtedness. While private creditors can simply stop granting credit and take their losses, the state has a more far reaching responsibility. For example, when people are evicted from their homes because

they are unable to pay the rent, the state has to provide alternative accommodation, because in many countries it is unacceptable that people are left on the street. Society has responsibility in this way for the consequences of consumer debt.

Because of a life-long liability for debts, people who become overindebted, lose positive financial incentives to actively participate in society. Insolvent people without hope become a burden for society, because the temptation to withdraw from the labour force, to hide from one's creditors, to abuse the courts or to work in the black market is high.

I.C.2.c) Integration, not Exclusion

This study advocates an approach involving the integration of overindebted consumers. They must be "recycled" into the financial system in such a way that they can participate again, and not be excluded from the market and society. A rehabilitative approach to debt settlement is good for the debtor and his family in the first place, but also for society as a whole. Putting the blame on the consumer and making him suffer for the rest of his life is a counter-effective response to the societal problem of overindebtedness, because it leads to the exclusion of citizens.

The system should encourage all the parties concerned to look to the future rather than to the past. When integration is the first aim, policy is not centred on the past, nor preoccupied with the question of who is to blame for the fact that the financial position of the debtor has gone wrong. The focus is on the future, and on how the person can restore independent participation in economic life, rather than remain dependent on his creditors or social security, or even worse. Discharge of debts restores to the debtor some measure of confidence in his capacity to arrange his future as he wishes, free from the dead hand of the past. Without such confidence, the debtor may lose even that minimum of self-respect that is a condition for his taking an interest in himself and his own life, and not turn away from society.

Because of the rehabilitation function of debt settlement, the debtor is encouraged to become an active member of society again, producing wealth rather than remaining non-productive. Discharge reflects an awareness that the productive resources of every individual are significant, and that by releasing the debtor from his past financial obligations, his renewed vigour will benefit society as a whole as well as himself. Seen in this way, the study's approach contains utilitarian elements, and may be justified from a public policy standpoint. By being allowed to regain his

position in society, the debtor contributes to the “common good” through being a productive member of society.

While traditional bankruptcy laws aim at a liquidation of assets in order to punish the debtor for past conduct, debt settlement stresses reorganisation of financial disorder in order to integrate the debtor back into society.

In order to give the debtor a new chance, it is essential that the individual's economic position is not undermined by a destructive procedure. The debtor must have a reasonable position to start from, not a ruinous one. Therefore an equitable exemption scheme is essential as well. Exemptions leave the debtor with the basic necessities of life and place the debtor back on track for the reconstruction of his financial life. Exemptions reflect what society believes to be necessary for the individual good. Through exemption laws, which place some goods outside the reach of creditors, the debtor's family is protected from living at an unacceptable standard of living. As such, exemptions contribute to the integration of debtors into society.

I.C.2.d) The Risk of Non-Payment

The spreading of risk should be established in such a way that the interested party, most capable of avoiding financial problems, and who can also take suitable measures in the event of problems, bears the risk in the first instance. A party's ability to bear risk depends on his/her capacity to avoid adversities and also on its ability to insure efficiently against those events. As is explained below, it is both economically efficient and socially just to place this risk with the creditor.

It is argued here that the creditors are the superior risk-bearers. Firstly, one should recognise that debtors think individually and consider only their own individual circumstances when taking on credit. Borrowers usually do not know whether they will become unemployed or seriously ill within a short period of time. These are not the sorts of event one takes into account when taking on credit.

The credit-grantor, on the other hand, thinks collectively. When commercial services are offered on a large scale, the creditor has to think collectively instead of individually. Risks are spread and absorbed as expenses. These risk expenses figure in the cost of credit and are borne by both consumers and taxpayers. Big lending institutions survey the market carefully and do not become vexed by the supposed reproachable conduct of particular borrowers and cost-consuming proceedings, because they calculate the risks precisely and spread these through the credit price to all their



customers. Accordingly, large-scale credit granting procedures are impersonal and strictly based on actuarial principles. From a creditor's point of view, these impersonal transactions lack the moral and ethical foundation of agreements concluded between two persons and upon which the traditional concepts of contract law are built.

Professional creditors, having gained experience through dealing with countless debtors, are more adept than the individual at monitoring borrowing. The creditor can forecast quite accurately the percentage of borrowers that will become unemployed in the coming year. So the creditor knows beforehand the percentage of outstanding credit which will not be repaid. Thus, the creditor can make a fairly good estimate of the risk he is running by lending the money, while the debtor often cannot. Write-offs are acceptable for creditors, provided that the cost is controllable and (re)insurable. Because the professional lender knows the risks, they are taken into account in their lending policies. Granting credit means accepting risks. A certain percentage of default is accepted as part of the costs of doing business and therefore treated as tax-deductible as well. The acceptance of such costs by the taxman also fits into the ideas of integrating overindebted people.

II The Legal Situation on Overindebtedness in the EU Member States

The legal situation on overindebtedness is split into **two areas of law**: the area of contract law where on the one hand according to the basic principle of the freedom of contract parties decide on the law and the market limits the power of the stronger party while on the other hand bankruptcy procedures are primarily governed by administrative public law where the state enforces the given regulation through supervised public procedures.

This distinction would leave the area of prevention to the market while compensation would be given through the state only after the problems have already appeared. But if, with regard to overindebtedness prevention is a necessary public task the state has to intervene at an earlier stage. This is in fact done largely at the national level through binding rules on social and informational consumer protection which indirectly regulate offers, products, and the behaviour of the lenders and borrowers. On the other hand, most states have introduced public bankruptcy procedures with important elements of private autonomy in so far as out-of-court settlements are even binding.

II.A Credit Contracts

Contract law covers the steps into credit and reaches its limits at the stage of insolvency. Its binding rules can have preventive effects and may also create the potential for cooperation between debtors and creditors as well as for products and services that accommodate the problems of overindebtedness.

II.A.1 Preventive Effects of Contract Law

II.A.1.a) Effectiveness of Private Law with Consumer Debts

Private law has increasingly been enriched by administrative elements to further protect consumers beyond the wording of the consent between lenders and borrowers. But although binding rules exist in private law, the system of their enforcement has not been changed. Social consumer protection rules have to be enforced by the debtor. There is no law without the judge and there is no judge without a party filing a suit. This is why the effectiveness of private law depends largely on questions of access to justice in the different countries.

If for example in *Germany* and *France* many claims from the creditors have to pass through the legal system, because private debt collection and even credit cancellation is restricted to this path, strict rules in civil law are much more effective than in those countries where judges are seldom involved in the monitoring of credit contracts. While in some states there is extensive jurisprudence on issues relating to consumer credit legislation, other states have hardly any at all. This is largely the case in the *United Kingdom* (UK), *Ireland* and the *Southern* Member States while in *Germany*, *France* and the *Low countries* the courts are intensively involved in consumer credit law. On the other hand, the *UK* has public regulatory bodies like the Financial Services Authority and the Office of Fair Trading which are involved in private law matters unlike their homologues on the continent. The *Scandinavian* countries, on the other hand, have semi-judicial bodies to enforce consumer law such as market courts and the consumer ombudsman system, which handle with private law issues thus guaranteeing its effectiveness.

A further element in effectiveness is the existence of **semi-public consumer organisations** or institutions such as the credit council in *France*, publicly financed consumer organisations with the right to class actions in *Germany*, or conflict commissions as in the *Netherlands*, or the above-mentioned consumer ombudsman system in the *Scandinavian* countries.

Empirically the soundness of credit extension seems to be even more influenced by the system of credit supply.



Here there are important differences especially between *Continental* Europe, where in principle credit is a bank monopoly and the *UK* and also *Belgium*, where according to the third EU Banking Directive only the taking of assets is a bank business. The bank monopoly for credit is rather strict in *Germany*. The *Netherlands* and *France* have exemptions for social non-for-profit lenders.⁷⁸

There is empirical evidence that the regulation of consumer credit is more effective where only bigger lenders are involved. Traditionally, usury has always been with small suppliers. That is why more scattered markets are more difficult to supervise, creating a wide variety of factors which further overindebtedness. In general, bank credit can be seen as the least problematic consumer credit, which has, for example, led *Italy* to restrict consumer credit to this sector only. But even in such a system credit intermediaries can become a problematic factor while traditionally, finance companies and credit card companies as well as doorstep credit are most visible in predatory or high-cost credit.⁷⁹ Another important element is whether there is general supervision, whether the general supervision is in the hand of one single institution, and whether this has significant power to regulate. In this respect there is a new trend in *Germany*, the *UK*, the *Netherlands*, *Sweden*, *Finland*, and *Austria* all of which have developed a specialised financial services authority while the other countries have confined this task to their central bank.

The following table shows the answers to relevant questions in the study which did not form part of the initial questionnaire. As these did not form part of the research, but may be an important disturbance variable, some aspects of the difference between countries should be highlighted in order to understand why the same consumer protection law in different countries may differ both in effect and effectiveness.

78 For further information see the overview on the respective bank law for Italy, Germany, the UK, the Netherlands, France and Belgium in *Reifner, U. (ed): Micro-Lending – A Case for Regulation in Europe, Social Finance vol.5, Nomos: Baden-Baden 2002*

79 *Domont-Naert, F./Dejemeppe, P.:* cf. footnote 54

Table 7: Systems of Credit Extension and Supervision

Member State	Credit System	Supervision
Austria	Licensed lenders (see internet database 2004): banks; credit institutions; credit card companies; finance companies	Financial Markets Authority (from 1 April 2004 on)
Belgium		
Denmark		
Finland	Consumer credits can be granted by banks, finance companies, credit card companies	Financial Supervision Authority (FSA)
France	Banks; insurance companies; finance companies; non for profit organisations; state agencies; credit unions; money lenders	the banking board (CB="commission bancaire") controlling rules; the credit and investissement companies committee (CECEI="comité des établissements de crédit et des entreprises d'investissements"); Bank of France
Germany	Licensed banks and Insurance companies	Financial Services Authority
Great Britain	No bank monopoly, all kinds of lenders: banks, finance companies, tallyman, credit card companies	Financial Services Authority for the bigger entities
Greece	Only banks and credit unions, finance companies, basically subsidiaries of the banks and in collaboration with the latter may also grant credit, mainly leasing contracts; credit card companies are permitted to supply consumers credit cards; "Credit companies" may be established after approval granted by the Bank of Greece.	Bank of Greece
Ireland		
Italy	Banks; insurance companies; finance companies; non for profit organisations; state agencies; credit unions; money lenders; credit card companies	Banks are controlled by Bank of Italy; also credit card companies, and big finance companies (art. 107 D. lgs. n. 385/1993); other finance companies are controlled by Ufficio Italiano Cambi (UIC, see art. 106 d. lgs. n. 385/1993, www.uic.it).
Luxembourg	Mainly Banks but credit from abroad especially Belgium and their automobile finance companies	"Kommission zur Überwachung des Finanzsektors zuständig" (CSSF): Commission de Surveillance du Secteur Financier
Netherlands	Banks, insurance companies, and their subsidiaries (finance companies, money lenders); not for profit organisations: only if they do not advertise with credit and if they charge less than the annual rate (6 %); state agencies: Communal banks (gemeentelijke kredietbanken); credit card companies	DNB (De Nederlandsche Bank), our National Supervisor of banks, but will be transferred shortly to AFM (Autoriteit Financiële Markten)
Portugal	Banks and specialised financial institutions selling indirectly through brokers and retailers	Bank of Portugal
Spain	State; banks; savings banks; credit cooperatives; credit financial establishments (for consumer loans, mortgage loans, financing for commercial operations, leasing, emission and management of payment instruments, bails and guarantees); electronic money entities	National Bank of Spain (Banco de España)
Sweden	Banks, insurance companies, finance companies and credit card companies	Finance Supervisory Agency

Some hypotheses for further research can be drawn from this table:

Most countries have concentrated consumer credit with larger lenders due to a legal monopoly or to unified supervision of banks and similar institutions. Some countries have exemptions for not-for-profit credit, such as *Italy*, *France*, *Belgium* and the *Netherlands*. These exemptions do not seem to be a significant cause of overindebtedness. Finally, this leaves the *UK* and *Ireland* with

many small suppliers of credit in a situation which might require a more detailed regulation with additional supervision adapted for the special non-banking market.

In the following subchapters these restrictions should be kept in mind but will not be raised again.

II.A.1.b) Contract Law in the Debt Process

To deal with overindebtedness by means of contract law the process has to start with the situation in which the consumer finds himself seriously overindebted. The process goes back from this situation step by step, considering which rights and obligations might have broken the cause-and-effect chain. It starts with the moment when insolvency is declared, goes back to when the debt accumulated to look at the conditions which led to and finally reaches the point at which alternative behaviour would have prevented the situation from developing.

Table 8: Steps into Overindebtedness and the Law

	What can be done?	Who is in Charge?	Law	Presence
Insolvency	Discharge, rehabilitation	State	Bankruptcy law	0
Credit cancellation	Defer cancellation, investigate true reasons	Creditor	Civil procedure and legal obligations	-1
Default	Refinance, prolong	Creditor	Contract law	-2
Problems in income or expenditure	Increase income, save	Debtor	Contract law	-3
Credit Agreement	Lower rates, instalment, more rights, time for reflection	Creditor, Debtor	Contract law	-4
Choice of product	Less credit, better credit	Debtor	Precontractual obligations	-5
Publicity, information and advice	Prepare for the risk, design better products	Creditor	Competition law, supervisory law	-6
Assessment of wishes and means	Lower expectations, more realistic assumptions about income	Debtor		-7
Education and social status	Education, social security, stable work	State	Public law	-8 Past



Overindebtedness is the level at which consumer debt in its present form generates monthly payments that exceed monthly disposable personal income. It is important to recognise that neither the amount of the debt load nor the amount of the monthly payment as such, represent the immediate reason for overindebtedness and therefore in spite of typical official statistics on debt loads per capita or person, provide no valuable indicator.

As outlined in the table above, overindebtedness can be resolved in various ways:

- Debt reduction with a consequent reduction of the monthly instalment
- Instalments are reduced through prolongment

- Fresh Credit is extended to refinance part of the outstanding instalments
- Income increases
- Reductions in expenditure

To prevent default, consumer protection law could give consumers more rights to adapt their credit arrangements and advice in difficult situations. Assuming that many of the risks affecting household liquidity are only temporary and that some of the incidents such as accidents, divorce or illness have quite calculable effects, and where only the creditor would have the means, data and experience to offer suitable solutions at an early stage, social consumer protection could introduce consumer rights for such action to be taken.

But such rights presuppose that the consumer is given a second chance to continue his monthly payments. If not, the law has either to simulate such contractual relations or declare the debtor bankrupt.

II.A.2 Protection in Default

The initial credit scoring assuming creditworthiness compared household liquidity (monthly income versus monthly expenditure)⁸⁰ with the instalments due. In the drawing up of the contract it was never assumed that the whole debt could be paid back at once, after the financed item had been bought. Even with the immediate liquidation of for example a car, the borrower would remain illiquid and consequently overindebted if the whole amount was due at once.

Therefore the final decision as to whether a person is overindebted lies with each single creditor. If the consumer is in default with payments in all Member States each affected creditor has the right to cancellation and early repayment.

This confers enormous decision-making power on creditors because a debtor who is not able to pay a single instalment in time will certainly not be able to repay the whole debt at once.

Even if still liquid, each debtor will therefore be overindebted if the creditor claims early repayment.

80 Some banks assume a fixed ratio with a maximum of 30% of income dedicated to the repayment of debts. This rate coincides with exemption laws. See Question 39 for Spain where for example 30% of additional income above € 1,010 can be seized; a similar regulation exists in Belgium.

The logic of this system comes from the concept of bankruptcy where creditors have to distribute the remaining assets in order to prevent that any of them receives more than the others.

This could lead to the assumption that a law which simply forbids credit cancellation could solve the problem of overindebtedness. This is certainly not the case. The right to cancel the credit and thus to break the principle of *pacta sunt servanda* is based on the assumption that the credit contract will anyhow not be fulfilled in the future because the consumer is already overindebted and the delay in payment is the expression of this factual situation. One might anyhow argue that the early repayment prescribed in the law is nevertheless a legal fiction because in practice the debtor will continue to repay in instalments, but under very different conditions. Insolvency procedures which create legally-binding repayment plans may therefore be understood as a prolongment of an adapted credit agreement. Such goals could probably also be achieved through consumer protection, forcing creditors into the development of such adapted contracts at a much earlier stage. A duty to refinance "needy" credit contracts would also fall into this category.

There is also another major problem. Creditors might have other incentives for early cancellation because they profit from the changed conditions, bargaining power and cost of the creditor-debtor relationship afterwards. This would of course significantly jeopardise the protection contract law normally affords both parties. Consumer protection law would therefore be obliged to prevent the misuse of cancellation rights for purposes other than existing overindebtedness because otherwise the right to cancellation would turn into a self-fulfilling prophecy.

There are yet other possible reasons as to why a creditor might have incentives to cancel credit contracts and cause overindebtedness in cases where the above-mentioned conditions are not present.

- The creditor could have a higher profit after cancellation than before. (Higher default interest rate than the contractual rate, direct access to higher payments, access to additional means of debt collection such as threats, court orders etc.)
- The creditor is offered a more favourable payment system in which the capital will not be reduced and lifelong payments can be expected.
- The creditor can use the weak bargaining position of debtors to draw up a less favourable agreement with him. (Additional securities, insurance, new start-up fees, additional credit)

- The creditor wants to concentrate all the debts of his client with his own bank through a consolidation loan.

II.A.2.a) Protection against Premature Cancellations

The existing EU-Consumer Credit Directive of 1987 did not address the problem of early termination by the creditor. Art. 8 of the Directive 87/102/EEC on Consumer Credit regulated the right of the debtor for early repayment only.

This right which has been integrated into all legal orders of the Member States has no direct impact on the situation of overindebted persons. It may have a preventive effect in so far as people can reduce their debts at an early stage. In practice, this has not been observed. Consumers who have the right to pay higher instalments in variable rate credit never make use of this opportunity.

The right to early repayment has even been blamed for giving unscrupulous lenders or intermediaries the opportunity of offering credit consolidation to overindebted persons by offering additional credit if they consented to refinance existing low cost credit at higher cost with a predatory lender. Savings banks in *Germany* have complained that this article would force them to watch clients to whom they had to deny additional credit being driven into overindebtedness through such practices, without their being able to insist on the continuation of the initial good credit contract. Such problems have to be dealt with where refinancing is restricted under national law.

The new draft Proposal of the Consumer Credit Directive has now addressed early cancellation and introduced informational and substantive elements into the law.

Art. 24 no. 1 b) requires the lender not to take "disproportionate measures to recover amounts due to them in the event of non-performance of such agreements." It is further requested that the creditor may inform the consumer "within a reasonable period of time ... to comply with his obligation or to apply for rescheduling of the debt." This does not limit early cancellation as such which is even permitted by referring to the right to "immediate payment in the event of default or invoke a clause providing an express resolute condition" but gives a right to a delay.

For overdraft credit, the suspension of drawdown rights is not delayed but related to the obligation to provide reasons and to immediately inform the consumer.

Art. 23 gives additional protection for guarantors by postponing "action against the guarantor only if the consumer, having de-

faulted on repayment of the credit, has failed to comply with a default notice within three months.”

The majority of Member States have restrictions as to the conditions under which the unpaid amount of credit can be made due in full.

Normally the following steps occur:

- Step 1: The consumer is in default
- Step 2: Default interest on arrears
- Step 3: Minimum default period or arrears
- Step 4: Cancellation of the contract or automatic acceleration of the unpaid sum
- Step 5: Grace period to pay the outstanding instalments
- Step 6: Effective acceleration, default interest replaces contractual interest
- Step 7: Intervention of the judge and/or start of bankruptcy proceedings

In most countries default is regulated.⁸¹ But although historically the *Mediterranean* states have harsh legal rules, these rules are not binding. This does not necessarily imply that debtors are treated less favourable than in other states. The behaviour of creditors depends largely on their size and the supervision procedures in force. Although, for example in *Portugal*, creditors observe rules similar to those in force in other Member States, there is no legal obligation to do so and they could easily agree others.

All countries allow early termination for insolvency (the principle of “fundamental breach” applies) especially if the value of the collateral is reduced or the consumer can be considered bankrupt.

Art. 33, sub c) of the *Dutch* Consumer Credit Act provides for such exceptional termination by the creditor as follows:

He may require full payment, if the debtor

- is two months in arrears, and after an official notice of delay
- has left the country or is planning to do so
- has died and the patrimony is not sufficient to pay the debts
- is bankrupt

81 See *Balate, E./Dejemeppe, P.*: Conséquences de l’Inexécution des Contrats de Crédit à la Consommation”, Etude AO-2600/95/000270 Commission Européenne, rapport final

- has sold the collateral
- has given false information when asking for credit

The mere fact that consumers are late in payments suffices in only a minority of states, in particular in *Italy, Greece, Portugal, and Spain*.

All others require a minimum time of default from seven to ten days in the *UK and Ireland*, up to two months in *Sweden and Belgium*. Instead of defining a time period, some countries define the number of instalments in arrear, ranging from a minimum of one instalment in the Mediterranean states to two instalments in *Germany and Sweden*. In addition to this requirement, most Member States also require a minimum of the outstanding amount indicated as a percentage of the unpaid total debt (*Luxembourg, Sweden, Denmark*) or the net credit (*Germany, Italy* for instalment purchases only) or the outstanding sum (*Belgium*) which may be divided into two different percentages according to the number of instalments (less if there are more instalments) (*Germany, Denmark*) and which ranges from 5% in these countries for long term loans to 20% in *Belgium*.

There is only one country which seems to have combined all these factors. The *Swedish* national expert answers the relevant question as follows:

“(Early termination by the creditor) is regulated in sections 20 to 24 of the Consumer Credit Act. They permit early termination of a consumer credit in the following cases:

- The payment is in default for more than a month and exceeds ten per cent of the credit, or two instalments are in default and exceed five per cent of the credit.
- The payment is in some way substantially delayed.
- Security for the credit has substantially decreased in value.
- It is obvious that the debtor, by evading, losing property or acting in some other way, avoids repayment.
- In all cases, the creditor must have retained the right to early payment in the contract.
- If the creditor wants to exercise the right to claim payment he must give notice of early termination of the contract four weeks in advance. If the debtor pays the instalments due during this period, he is not liable to pay the rest of the credit in advance.”

The third element restraining cancellation or acceleration of debts is the period after cancellation or notice in which payments by the debtor are still possible and which give the right to further repay-

ment of instalments instead of the whole unpaid sum due. While nearly all countries providing such a **period of grace** which may be seven days, as in the *UK* or up to two months in *Belgium* and four weeks in *Sweden* give this opportunity. In *Germany*, under art. 498 para.1, sub-para.1, no.2 BGB (Civil Code), lenders must allow borrowers a two-week extension in the event of a delay in payments of a consumer loan to enable them to make up the outstanding amount. Lenders may terminate the agreement only upon expiry of this period. Lenders must send a notice stating that the total amount outstanding (previously not due for payment) will be demanded if the borrower does not pay the arrears within the time limit.

There is also a more complicated question which the draft Proposal of the EU seems to overcome by accepting two ways of early termination which are sometimes seen as irreconcilable in national legal orders. The question as to whether **acceleration clauses** are allowed has for example in *Germany* been disputed for a long time. The difference between acceleration clauses and the right to cancellation lies in the necessity for the creditor to take action and inform the consumer. In *Italy* and *France* this even implied the need to involve the judge or at least a summary procedure if it is not otherwise agreed in the contract. In *Germany*, where the courts have declared void acceleration clauses which they assume to be a circumvention of the system of cancellation, the right to early termination depends on criteria such as notice, fault and reception of the notice. In *Denmark*, likewise, early termination is seen as part of the principle of fundamental breach.

This may further restrict these rights through the bona fide principle wherein courts have ruled that creditors may even be forced to refrain from cancellation, if the debtor (which in the corresponding *German* cases had always been not a consumer but an entrepreneur) is in a needy situation and cancellation would ruin him ("cancellation at the wrong time"). The study did not research these difficult differences between such acceleration clauses and cancellation rights in national legal orders, but how these rights are assessed is significantly different in nearly all national legal orders.

Finally, it should be mentioned that *France*, in particular has a peculiar system in which extensive social rights are not given directly to the parties but their application is at the **discretion of the judge** who may exert considerable flexibility in the individual situation. This may encourage both overuse and misuse of social rights, but may also give rise to the disadvantage that equal treatment for all consumers may not be guaranteed. The judge as

a “social engineer” through his application of general clauses is a point of discussion in all legal orders.⁸² This leads to a much broader system of social consumer protection especially where the judge has to be involved in early termination.

Article L312-22 of the *French Consumer Protection Code* gives the creditor an incentive not to cancel the credit contract. He can increase the interest rate in accordance with a regime fixed by decree. If the creditor cancels the credit, he has to ask for an order under L1230 of the Civil Code. Should he request early repayment, he is entitled only to a default interest not higher than the contractual interest rate.

Article L313-12 of the Consumer Code gives the judge the further right to interrupt prosecution, grant a delay of grace to the debtor during which no further interest accrues. The judge may also fix a new prolonged repayment schedule which may not exceed two years of the initial lifetime of the credit contract.

The following table tries to summarise all the different elements all present in the *Swedish* example. It should be remembered that, for example, the minimum amount refers to three different balances: net credit, total payments, and unpaid sum.

Table 9: Conditions for Early Termination

Member State	Minimum amount	in default for	Time for payment	Right to continue if paid?
Austria	None	6 weeks	2 weeks	Yes
Belgium	20%	2 months	1 month	Yes
Denmark	10%/5% ⁸³	30 days	None	No
Finland	10%/5% ⁸⁴	1 month	4 or 2 weeks	Yes
France		1 instalment		
Germany	10%/5% ⁸⁵	2 instalments	2 weeks	No

82 See Reifner, U.: „Good Faith”: Interpretation or Limitation of Contracts? The Power of German Judges in Financial Services Law, in: *Brownsword, R./Hird, N.J./Howells, G.: Good Faith in Contract*, Ashgate: Dartmouth 1999, p 269-310

83 Art. 29 Consumer Credit Agreements Act specifies this general principle to the effect that the delay must exceed 30 days and that the amount due must be at least 10% of the total debt (or 5% if it consists of more instalments or all the remaining debt).

84 The amount in a lump-sum credit must be at least 10% or, if it concerns more than one instalment, at least 5% of the original amount of the credit or, in the case of a goods-or-services-related credit, of the credit price or if it concerns the total remaining claim of the creditor.

Great Britain		7 days	7 days	
Greece	None	1 instalment or more (case law)	None	
Ireland	None	10 days	11 days	
Italy	12,50% ⁸⁶	1 instalment	None	
Luxembourg	20%	2 instalments	one month	Yes
Netherlands		2 months		Yes
Portugal	None	1 instalment	None	
Spain	None	1 instalment	None	No
Sweden	10%	1 month and 2 instalments	four weeks	Yes

II.A.2.b) Default regulations – Interest, Compounding

An important tool for keeping credit contracts alive and give consumers a chance to return to normal payment of instalments, instead of acceleration and the path into overindebtedness, are regulations which discourage the creditor from cancelling the contract and replacing contractual interest by unilaterally defined default interest.

The basic dogmatic assumptions about default interest vary among the different legal orders. While for example in the *UK* and the *Southern* Member States default interest is seen as something the parties of a contract can agree, the *German* doctrine in particular has always held that default interest is part of a claim for damages and is limited by the actual damages a creditor can claim. This also explains how its default interest rate is limited by market parameters and not by contractual parameters. Most countries follow an interim approach. They limit the right to define the default interest rate unilaterally but link its level to the agreed contractual rate plus a margin fixed by law. The *Scandinavian* countries have both, a legal default rate and the right to agree on a higher rate.

There are basically four types:

- Contractual freedom (*UK* and *Ireland*)
- Contractual freedom but usury supervision (*Italy*, *Luxembourg*)

85 More than 3 years duration.

86 For instalment purchase contracts.

- Relating the default interest rate to an objective market rate, but allowing also the contractual interest rate if this is agreed and higher (*Denmark, Sweden, Finland*)
- Relating the default interest rate to the contractual rate with a margin of between less than 1% and 5% (*Austria, Belgium, the Netherlands, Greece*)
- Relating the default interest rate to an objective market parameter like the base-rate (*Germany*)

This difference leads to effective differences in regulated default interest rates of between 7% in *Germany* and 20% in *Spain*, or much higher market default rates in the *UK*.

Table 10: Maximum Default Interest Rates

Member State	Regulation on Default Interest Rates	Actual Maximum Rate ⁸⁷
Austria	Contractual rate + 5%	13%
Belgium	APR of the contract majored by 1/10	8.8%
Denmark	Maximum set by Payment of Interests Act. Basic interest rate (set by Danish National Bank) plus 7%	
Finland	Contractual interest rate or the basic interest rate set by European Central Bank (currently 4.25%) plus 7%	11.25%
France	Contractual interest rate, if rescheduled maximum the legal rate of 3.29%	8%
Germany	5% above the base rate (currently at 1.97%)	6.97%
Great Britain	No	?
Greece	2-2.5% above the contractual rate	10,5%
Ireland	No	?
Italy	No, but judge may reduce it if it is "excessive"	?
Luxembourg	No (but in practice the contract rate + 2%)	10%
Netherlands	2.5% above the contractual rate	10.5%
Portugal	No	
Spain	No (but may be reduced through usury rulings to 2.5 time the overdraft interest rate)	20%
Sweden	Contractual interest rate or the basic interest rate set by Swedish authorities plus 8%	12.25%

Another important restriction to default can be seen in the way repayments are regulated.

In the *Southern* Member States, the old Roman law banning **anatocism**, which prohibits charging interest on interest, is still in force and is revived for consumer protection purposes. In *Italy* for example, the Supreme Court declared void a number of clauses on overdraft credit which were in contradiction to anatocism. *Portugal* reported the effectiveness of this rule in dealing with soaring debts. There, accrued interest has to be debited to a separate account and cannot be compounded to the interest bearing capital.

There is a comprehensive regulation in *Greece* which restricts anatocism:

87 In this table we assume that the contractual rate is 8% p.a.

"Credit contracts from before 1998 may provide that interest in default is anatocised after the first day of default every 6 months (or longer period if agreed-smaller period is forbidden). If there is no agreement in the credit contract regarding anatocism, then anatocism may take place according to art.296 that interest on interest may be paid only if agreed or only after issuing proceedings. But in both cases the interest due may refer to a period of one whole year at least. As an exception to this rule, art.111 of the Introductory Law to the Civil Code provides for the possibility of anatocism every six months. If they do not provide for anatocism, anatocism may take place every 12 months. After 1998 Law 2601/1998 provides that anatocism may take place every 6 months, even if there is no agreement."

In *Germany*, as in the *Northern* Member States, anatocism as a historical principle has been largely abandoned. The German Federal Supreme Court holds that this principle does not hold true for bank credit because it does not limit the right to claim additional damages for unpaid interest.

But Germany has revisited the idea of limiting **pyramiding debts** through special interest legislation for consumer credit. In the event of default, the default interest has to be debited to a separate account. All payments are first debited to the principal while the default interest is kept separate and bears interest only at the legal rate of 4% p.a. Compounding of default interest is excluded. The rule that repayments first reduce the principal is also in force in *Luxembourg*. It has the effect of giving debtors a greater incentive to repay because their payments initially regularly reduce the capital by a considerable amount and thus the creation of new default interest until the principal is paid off. After that, no further default interest beyond the 4% will accrue, so that the debt can be significantly reduced. Pyramiding as it existed before is excluded. The same effect is achieved in *France* through the above-mentioned power of the judge to reduce default interest rates or the application of the legal rate after rescheduling of the debts.

Similarly in *Belgium*, payments must be allocated prioritising payment of the principal. Moreover, interest on arrears can be calculated only in relation to the capital element of unpaid monthly instalments (in the case of simple arrears) or on the outstanding amount, being the amount required to repay the element of capital not yet repaid (where the loan is cancelled).

An interesting comparison can be made with **rent arrears**. While loans represent the use of money capital, rent agreements represent the use of fixed capital. In each case interest is paid either as a money interest or as a rent. But in the case of rent agreements acceleration of the remaining debt is also a problem in cases the



landlord cancels the rent agreement and claims the immediate return of his fixed capital through eviction.

Nearly all Member States have either developed protective rules or offer state subsidies which clearly aim to keep the tenant agreement alive and the tenant in his home instead of becoming homeless.

Table 11: Tenants' Protection against Eviction ("Acceleration of Fixed Capital")

Member State	Regulation on Eviction
Austria	§ 33 Landlord and Tenant Law Act: Eviction only after a court title. Duty to give reasons before. Payment of arrears before final court decision reinstates into the contract.
Belgium	Eviction only after application to the Juge de Paix and with a court order. Attempt to resolve matters through conciliation before the Juge de Paix. The Juge de Paix may set a period for payment to be made in order to avoid an eviction. Centre Public d'Aide Sociale has to be informed prior to eviction and that the tenant must be allowed a period of one month in order to find alternative accommodation (Law of 30 November 1998).
Denmark	In case of the tenant's non-fulfilment of the payment obligation the landlord must give the tenant written notice demanding payment within 3 days. Eviction is excluded if the tenant pays the amount due within the 3 days.
Finland	Act on Residential Leases: Time for giving notice of discontinuance of the contract is 6 months for the landlord. The landlord has to give a warning. Reinstatement if the tenant stops the breach. For eviction the landlord must have a court decision.
France	To avoid eviction of the tenant for non-payment of rent, the judge may grant a period for payment to be made. These renewable periods may extend to up to 2 years. When eviction is ordered, the tenant may still ask the judge for time to move out. These periods are renewable and may extend to up to three years.
Germany	If the court makes an order for eviction it may grant the tenant a period of grace not exceeding one year (§ 721 Code of Civil Procedure). The debtor may then claim for protection from execution. Eviction is suspended if it constitutes an unreasonable hardship (§ 765a Code of Civil Procedure).
Great Britain	The landlord must take court proceedings in order to enforce any right of re-entry, and to obtain an Order for Possession. The legislation does not govern the grounds on which the landlord may claim such right of re-entry, just its exercise (Eviction Act 1977).
Greece	No specific regulation (the general provisions of the Civil Code apply).
Ireland	The landlord must give the tenant an advance notice of their intention to end the agreement. Under the Housing Act 1992, the notice to quit must be in writing and served at least four weeks before it is due to come into effect (three months notice is required on a quarterly tenancy). The landlord must still apply to the relevant court for an eviction order if the tenant refuses to leave.
Italy	Tenants can make an application to the court to obtain delay of the eviction, if there are particular circumstances (old, ill, family's members, and others). Special laws for emergency times under which tenants can delay eviction. Delay is automatic, if there are very old people, or severely handicapped persons, who live in the house, or if tenant hasn't sufficient income (to find another house). Landlord has to apply to the court if he doesn't agree.
Luxembourg	Justice of the Peace may order that she/he be granted a stay of execution in relation to the decision in question not exceeding three months, but it may be extended twice, on each occasion for a period of not more than three months. (Only if it is completely incompatible with the personal needs of the other party.)
Netherlands	Eviction can be done if the rent has not been paid (art. 18 Huurwet)
Portugal	No special regulation
Spain	Article 22.4 of the Law of Civil Procedure allows the occupier to stop the eviction if all arrears are paid. This measure is only allowed once.
Sweden	A tenant who has defaulted on the rent must be given notice in a prescribed order and social welfare authorities must be notified of the fact. The authorities can then step in to pay the rent. If they do not intervene, notice becomes effective unless the tenant within a certain period pays the due rent. If the tenant fails to do so, the court may give an eviction order.

The lessons that can be learned from these schemes are as follows:

- Acceleration of the capital is only possible under the supervision and with the consent of the judge, which guarantees the effectiveness of the regulation (similar to the acceleration of debts in *France*).
- Until the final court order or in *Spain* until the eviction date, payment of arrears reinstates the debtor into the normal contractual rights and obligations.
- Nearly all countries grant additional delays mostly decided on the merits of an individual case by the judge.
- Special social reasons can be invoked to prevent eviction.
- Some countries such as *Germany*, the *Scandinavian* countries and *France* request close cooperation between welfare offices and courts in cases of eviction, in order to save the higher cost of homelessness through early intervention.

These ideas may indicate where the regulation of the acceleration of money capital in credit contracts might lead.

II.A.2.c) Wage Assignment

Instalment credit, the most common form of consumer credit, is tailored in the form of repayment out of future monthly income. It is thus the legal expression of the economic insight that consumer credit is basically an anticipation of future income from work undertaken earned in the form of wages.

Such wages, however, are not primarily designated for the repayment of credit but for the actual consumption needs of the debtor and his family. Only that part of the disposable personal income which is the counter-value of the use of the financed goods or services per month serves as a source for the repayment. This relationship is apparent in credit scoring systems where all information on income and fixed or variable expenditures are taken into account (liquidity check).

In economic terms, the consumer seems to give part of his future monthly income away. In legal terms it would be expressed as the assignment of those parts of future income to be used for payment of the instalments. Through the assignment of future wages to the creditor, the creditor would have direct access to the source of income.

But there are important objections:

- Wages are not separable into quotas allocated for certain expenditure items and their stable flow is not guaranteed. In the event of a loss of income, and where the wage assignment claims can no longer be met out of disposable income, such claims are still valid and enforceable and can threaten the consumption of the debtor and his family.
- The assignee loses important freedom and decision-making power on his future assets. In a financial crisis, the debtor cannot decide which claims should be preferred or which investments should have priority before the payment of debts. One could even imagine that slave-like conditions would occur if a debtor has tied up his entire income in wage assignments.
- Wage assignment favours those creditors who have a constant and permanent creditor-relationship with the debtor. These are usually banks and other money lenders. Short-term creditors supplying food and services are disadvantaged.
- Wage assignments circumvent debt enforcement procedures especially wage garnishment which has to be sanctioned by a judge and having regard to an important body of ancient debtors' protection law.
- Finally, wage assignments burden the debtor's employer with extra work and costs and are a potential source of conflict. As the protection law for wage garnishment usually also applies to wage assignment procedures, the employer has to fulfil the functions of the judge without pay. Employers may therefore discriminate against overindebted persons because they do not welcome this additional workload and fear hostility when the claims underlying the assignment are disputed.

These concerns explain why the assignment of wages mechanism is restricted in all Member States although the level of restriction varies.

Table 12: Wage Assignments

Member State	Allowed	Comment and Restrictions
Austria	No	§ 12 (1) Kündigungsschutzgesetz: Wages or salaries of consumers may not be assigned to entrepreneurs as a security or for the fulfilment of future claims. But there exist forms of circumvention.
Belgium	Yes	The Law of 12 April 1965 on the protection of workers' income provides that, for the assignment to be valid, certain formalities must be observed: a separate document a copy of the assignment to the employer- if the purpose of the assignment is to guarantee repayment of a consumer loan, the document must recite the articles of the Law describing the procedure enabling the consumer to object
Denmark	No	
Finland	No	
France	No (?)	Wage garnishment begins with a conciliation hearing before a

		judge in a court of first instance. The judge may grant time for payment and check the validity of the claim. If the judge does not grant time for payment and if the debt cannot be repaid, garnishment occurs during the following week. The employer is notified of the order and the notice includes the percentage of the salary to be paid.
Germany	Yes/No	Although not foreseen in the Civil code generally accepted but by law reduced to the garnishable part of the income. Wage assignment clauses have in its effect been restricted to the loan which has given rise to its assignment. The employer can exclude the assignability of wages in the labour contract. This is sometimes done through collective agreements (e.g. Volkswagen).
Great Britain	Yes	Deduction from wages by an employer is subject to an express prior written agreement from the employee.
Greece	No	Wage can neither be garnished nor attached (art. 464 Civil Code; art. 982 par.2 Code of Civil Procedure)
Ireland	No (?)	Assignment of wages is neither allowed nor prohibited by law but in practice it is never written into credit contracts. However, given that there is no law allowing attachment of earnings in relation to non-payment of civil debt yet (there have been proposals) either, any such attempt would be unlikely to be upheld.
Italy	Yes	But only one fifth can be assigned; see d.p.r. 5.1.1950 n. 180
Luxembourg	Yes	Restrictive regulation setting a rate for the ability to assign and to attach earnings, pensions and benefits. Special procedures prescribed for the payroll of civil servants, the salaries of employees. The principal and ancillary sums related to this income are targeted, with the exception of sums allotted by way of repayment of set fees.
Netherlands	Yes	Employee has the right to 90% of the minimum wages.
Portugal	Yes	As provided for in article 824/1, item a) of Code of Civil Procedure, 1/3 of one's wages can be assigned.
Spain	Yes (?)	Wage garnishment is restricted.
Sweden	No	It is not permitted to assign salary or wages before they are due.

Austria, France, Denmark, and Greece exclude the possibility of wage assignment. *Sweden* and *Finland* allow wage garnishment only for claims that are already due. This excludes provisional wage assignment clauses in credit contracts.

All other countries restrict wage assignments to the proportion of disposable income remaining after living expenses have been met. This usually happens automatically in so far as the employer has to verify this amount when the claims are made. *Luxembourg* requires that this proportion is restricted by an agreement. In the *UK* and *Belgium*, wage assignments have to be stated in writing. *Belgium* requires separate documentation and information must be supplied to the employer. In *Germany*, a simple agreement between employer and employee or a relevant collective agreement excludes the assignability of claims from labour contracts. This is still possible when the creditor has already turned to the employer although a court ruling of a lower court holds that this contradicts good faith.

II.A.2.d) Co-liability of Spouses

Consumer credit is used for consumption purposes. People living in a family mostly consume collectively. Expenditure is also shared. Through partition of labour the unproductive household

work may be undertaken by one partner while the other undertakes the productive earning part. Part time work or different levels of income may also form part of a household as a collective earning and spending unit.

Consequently, credit used for consumption is not only used by one household member but by all of them. Correspondingly, the income used to repay the debt is usually derived directly from the income or labour of all household members. This is why creditors prefer to reflect this relationship in the credit contract in that both partners enjoying the benefit of the provided capital are also liable for its repayment.

Historically, this posed no problem because only the head of the family and earner of the family income could contract for the whole of the family. This was the *Pater Familias* in Roman law. The family was seen as a hierarchical earning and spending unit.

Modern society with its principle of individual freedom and equality between spouses has replaced the family as a legal unit with a group made up of single members. Each member is responsible for his own actions. Even where both partners want to act jointly, this should be based on the individual decisions of both partners at the moment when contracts are concluded.

Some national legislation within the European Union still refers back to the old family structure in so far as one partner has the right to contract on behalf of the other. Art. 220 of the *French Civil Code* reads: "Each spouse has the right to enter into a contract alone for support of the household or the education of the children: any debt thus contracted by one of them binds the other in solidarity." But in *France* as well as in *Belgium*, the *Netherlands* and *Germany* (art. 1357 Civil Code), the scope of its application has been reduced to normal expenditure and does not cover credit contracts. In *Germany*, couples living apart are excluded.

In *Portugal*, credit contracts are still subject to the general regulations on joint liability of spouses laid down in the Civil Code (articles 1690-1697). Debts incurred during marriage for the benefit of both spouses are considered joint debts. Thus, both spouses are responsible for repayment. In *Spain*, it depends which matrimonial estate has been agreed between spouses. In the case of a joint estate their common assets can be used by creditors to meet their claims. In *Italy*, art. 186 of the Civil Code makes a distinction for couples in a joint regime where the acquired goods were destined for the household. Only half of the value of common goods may be used for the debts of one of the partners. In

Finland, there is still co-liability for cost of living debts (food) and for housing and summer residence debt.

In *Sweden, Ireland, Great Britain, Luxembourg, Greece, Belgium* and *Denmark* no such co-liability exists. Each partner is liable only for what he or she has agreed to personally.

With the exception of *Portugal*, it seems that consumer credit contracts create debts only for the person who has signed either the credit contract itself or a personal guarantee.

But such individualisation of family economics at law has not eliminated the problems of joint economic investments where debt problems of one member of the family may lead to overindebtedness among the others.

As far as minors are concerned, no European legislation gives minors the right to co-sign parental credit contracts. The protection of minors does exist also with regard to the ability of their parents to represent them at law. But as soon as minors reach legal majority at the age of 18, they can assume the same responsibilities voluntarily as post partners of a couple.

Furthermore most legislation denies parents the right to represent their children in so far as credit contracts or guarantees are concerned.

In *Germany*, art. 1822 nos. 8–10 of the Civil Code excludes such representation without consent of the family court.

In *Belgium*, authorisation by the Juge de Paix is required for a minor to be able to take out a loan. This rule also applies to emancipated minors. If such authorisation is not obtained, the credit agreement will be void and the minor will not have to repay the sums due unless the transaction generated a profit for the minor. In addition, the Law of 11 June 1991 provided that the income of minors cannot be used to provide a guarantee in respect of a consumer credit agreement.

Under section 139 of the *Irish* Consumer Credit Act, it is an offence to send circulars knowingly to minors offering credit. Credit agreements with minors will not be enforceable in contract law, except insofar as they are for the minor to provide for "necessaries".

In *France*, arts. 388, 1304 and 1305 of the Civil Code prohibit banks from granting an advance on an account which may be assimilated into a loan to children.

As long as families stay together and keep up their economic unit with common goods, income and expenditure, all family members

are usually in equally difficult economic position. The economic situation of the family household is also the economic situation of each of its members.⁸⁸

This changes when the household unit is dissolved. In such a case joint liabilities for debts incurred to finance the household become individual debts for separate households. Such debts may cover capital used by the other household unit. The problem has come to light through the enormous increase in divorces which have doubled in *Germany* over the last thirty years, such that 40% of all newly marrieds may expect to be divorced. In the United States, the level has already risen to 56%. The following table reveals a significant difference between *Italy, Spain, Ireland, Portugal* and *Greece*, where divorce rates are rather low, and the rest of the EU Member States where divorce rates are, as in *Denmark* and *Belgium*, nearly three times higher than in these states.

Table 13: Marriage and Divorce Rates in the EU (2001)

Marriage and divorce rates: EU comparison, 2001		
Member State	Rates per 1,000 population	
	Marriages¹	Divorces²
Austria	4.2	2.5
Belgium	4.2	2.9
Denmark	6.6	2.7
Finland	4.8	2.6
France	5.1	2.0
Germany	4.7	2.4
Great Britain	5.1	2.6
Greece	5.4	0.9
Ireland	5.1	0.7
Italy	4.9	0.7
Luxembourg	4.5	2.3
Netherlands	5.1	2.3
Portugal	5.7	1,8
Spain	5,2	1,0
Sweden	4.0	2.44
EU Average	5.1	1.9
<i>Source: Eurostat</i>		

88 There is, of course, the situation where the possibility of distinguishing between economic behaviour and legal form is exploited for financial reasons. Couples living apart may concentrate all debts on one partner and all income and assets on the other. Such fraudulent behaviour to thwart creditors is difficult to manage and is usually found among people with entrepreneurial skills who are able to manage their assets independently. It is seldom observed in truly overindebted households.

Accordingly, the problem of the co-liability of spouses in consumer credit as a major reason for overindebtedness has primarily been recognised in those countries where the divorce rate is rather high.

In its draft Proposal for a new Consumer Credit Guideline the European Commission has proposed different measures which would indirectly profit spouses by limiting personal guarantees especially for overdraft credit: personal guarantees have to be renewed after three years and enforcement should in general be secondary to the main debtor with a delay of three months before prosecution.

Art. 23: Performance of a surety agreement

1. A guarantor may conclude a surety agreement guaranteeing repayment under an open-end credit agreement for a period of three years only. This surety may be extended only with the specific agreement of the guarantor at the end of that period.

2. The creditor may take action against the guarantor only if the consumer, having defaulted on repayment of the credit, has failed to comply with a default notice within three months.

3. The amount guaranteed may only equal the outstanding balance of the total amount of credit and any arrears in accordance with the credit agreement, with the exclusion of any other indemnities or penalties provided for by the credit agreement.

In addition according to art. 24 1 b) of the Proposal before acceleration of the debt the guarantor will have to get a

“... a prior default notice requesting the consumer or, where applicable, the guarantor to comply with his obligations under the agreement within a reasonable period of time or to apply for rescheduling of the debt.”

Meanwhile, countries with high divorce rates are concerned about the co-liability of spouses especially after divorce.

Perhaps the most far-reaching development has been in *Germany* after a heated public debate where the civil courts were split over these issues. Finally, the Federal Constitutional Court intervened in a much criticised (but finally accepted) landmark decision that the civil courts have to seek remedy for children or spouses who through mere emotional ties to the main debtor had either co-signed or guaranteed a loan whose repayment obligations would far exceed their expected personal capacity to pay in the future.⁸⁹

⁸⁹ See Wertpapier Mitteilungen 1993 p 2199 ff; restated in Neue Juristische Wochenschrift 1996 p 2021; an extensive interpretation to this new principle has been given by the Federal Supreme Court (Bundesgerichtshof) in: Neue

"The civil courts must investigate whether the wording of the contract results from a structural imbalance in bargaining power and, if this is the case, rectify the position under civil law through the application of general clauses."⁹⁰

A guarantee as well as a contractual obligation of a spouse or a child (or other directly dependant person) is in contradiction to "good morals" and therefore void if this person (1) gained no significant benefit from the credit, (2) signed the contract only because there were emotional or other non-economic ties to the main debtor and (3) was at the time the contract was concluded visibly and apparently unable to repay the debt in his or her lifetime, so that the creditor "exploited" this weak situation to obtain additional security. This does not have to be intentional. The objective situation presupposes such behaviour.

This development led to the introduction of a general principle of taking care of the interest and situation of the contractual partner as a secondary duty prior to conclusion of the contract in art. 311 of the Civil Code.

The ninth Chamber of the German Federal Supreme Court also applied the *clausula rebus sic stantibus* to marriage, arguing that similar to the power of *Austrian* family courts after divorce, a main "res" for co-liability had changed, so that the debts had to be adjusted to the new situation by the judge. Parties aware of the imminent divorce would have consented to a partition of debts after divorce in proportion to the personal profit they had derived from the credit, which would presumably be half for each unless proved otherwise.

In *Austria* according to art. 25a Kündigungsschutzgesetz, banks have to instruct spouses co-signing or guaranteeing a new or already existing credit on a separate document (1) that, if the spouses are solely liable the creditor can demand the full sum of the debt from each of them in full irrespective of who enjoyed the credit, (2) that the liability survives divorce and (3) that in the case of divorce only the court can limit the liability of one of the spouses in accordance with art. 98 Marriage Law to a loss endorsement, which has to be requested within a year after the divorce.

In *Greece*, the guarantor has the same rights of information from the initial credit contract as the main debtor.

Juristische Wochenschrift 1998 p 597 ff. For a general description of the extensive use of general clauses of good faith and good morals in German credit law see Reifner, U.: cf. footnote 82.

90 L.c.

In *Ireland*, no general protection is given in consumer credit but under the Family Home Protection Act 1976, a spouse cannot mortgage or give the family home (in his/her sole name) as security for a loan without the express written consent of the other spouse. If a family home is in joint names, any such loan would not be enforceable without both parties consent.

In *Finland* and *Sweden*, each person, also spouses, are independent and liable for their own debts only. In Finnish Marriage Act, co-liability is prescribed for a debt, which is taken for the living expenses of the family. Creditors do not often rely on this rule.

The guarantees given by family members were widely discussed in early 1990s during the depression years. In case law, the information duties of the banks to the partner were underlined in the beginning of the 1990s. The case law and public concern led to the enactment of the Act on Guarantees in 1999. According to it, the creditor has an obligation to inform the guarantor both before the contract is signed. If the debt, for which guarantee is given, is not specifically defined in the contract, the creditor has also a duty to inform the guarantor as long as the contract is in valid.

For the *UK* there appear to be no restrictions. But in the discussion on the German case it became clear that in the UK the creditor is supposed to warn spouses in the same way as the regulation in Austria requires.

The whole issue will certainly become more important as family structures become looser. The legal solution may lie in a more economic understanding of the co-liabilities of spouses and adult children. There are two distinct cases: in one case, spouses contract debts for their shared living expenses or their joint business. In this case, the idea of the *clausula rebus sic stantibus* seems to be the most appropriate for consumer credit relating to already consumed investments.

For other liabilities, the co-signature of a spouse or child to rescue a debt or to support credit for purposes which are clearly in the sole interest of the main debtor, the signature is in fact a guarantee which has been "donated" to the bank and the main debtor together. Such donations are viewed critically by legislation and can be revoked. Such revocation should be possible in the case of separation and divorce. This would significantly limit the extension of donations with such emotional connotations.

II.A.3 Limits for the Debt Burden

The amount of the monthly instalment is a decisive parameter in overindebtedness.



At a first sight, the size of the instalment is a mere function of the amount of debt and the repayment period. The higher the credit and the shorter its life-time, the greater will be the amount of the instalment. It seems that the cost of credit does not play a more important role than the amount of capital the debtor has taken out.

A closer look reveals that the burden of cost has much more influence on overindebtedness than the burden of the debt as such.

II.A.3.a) High Cost Credit and Overindebtedness

High cost credit will be more likely to lead to overlapping instalments for the same consumption period.

A higher net credit presupposes bigger investments and bigger investments are normally made for longer lasting goods and services (cars, household equipment, and education versus overdraft credit to bridge temporary income problems, loans for holidays or just for liquidity). The lifetime of a sound credit contract will always be adjusted to the lifetime of the financed goods and services, and usually benefit should be derived from their use (productive credit). Valuable goods have a longer life. So, higher credit amounts pose no problem if the number of additional instalments matches the longer life expectation of the goods.

But if the additional instalments are due to higher cost, only the relatively shorter lifetime of the goods will saddle the debtor with overlapping instalments for the same consumption purpose in the future. (The financed car has been replaced by a new financed car before the old has been paid off.) Consequently, the debtor will be overindebted shortly after the acquisition of the new goods or service replacing the exhausted goods or services.

A consumer with a fixed disposable income would therefore have to take longer periods for the repayment of more costly credit than he is supposed to. This prolongment will again create additional credit costs which in turn further prolong the credit. The threat of debt pyramiding without equity and double payments will increase.

If this threat increases, the failure rate will increase which in turn gives creditors an incentive to charge higher risk premiums for the credit. This will further aggravate the situation and lead vulnerable consumers into a vicious circle.

Historically, *Belgium* in particular, limited the number of instalments according to purchased goods.

High cost facilitates the extension of far too small credit amounts to vulnerable consumers.

Where high cost credit is possible, high transaction costs are also possible, incurred when more personal contact is necessary and smaller credit amounts are at stake.⁹¹ Small credit amounts are less likely to represent productive investments. They are mostly due to liquidity crises or unconscious use of credit for short term "wants", reflecting immediate responses to advertising and irrational stimuli without adequate reflection.

Small amounts to solve liquidity problems are normally dealt with by overdraft credit if they are required merely to buffer cash flow problem in income and expenditure cycles during the course of a year.

For example, some expenditure is incurred at the beginning of the month while employees get their salary either on the 15th or at the end of a month. Some fees or premiums benefit from significant reductions from the contractors if they are paid once a year in advance. It would be a rational move to finance these premiums, thus reducing transaction costs.

The bank monitors the development of the overdraft and reduces the limit if there is a danger that instead it may become a source of permanent financing. This monitoring function performed by banks is very helpful in preventing overindebtedness. When they realise that the overdraft is not being reduced, many banks refinance such overdraft credit into an instalment credit, which then adjusts the debt burden to the income cycle, thus preventing overindebtedness.

If instead debt is taken out either spontaneously as credit card credit, hire purchase or from high cost creditors such as Provident in the UK, the exorbitant interest rates of more than 100% indicate that the credit is not bridging a liquidity crisis but is providing additional consumption facilities or even the temporary refinancing of instalments due to the detriment of future liquidity. This is much more likely to lead to overindebtedness than bank overdraft credit.

High cost credit favours predatory lending. High interest rates and high returns make archaic methods of debt collection and credit extension, nowadays more rationally organised, attractive once more. If 100% APR can be charged, unskilled brokers and sales-

91 For an empirical evaluation, see Church Action on Poverty, Counting the Cost of Credit - A Report of the National Policy Forum on High Cost Credit, 9 July 2001: "The campaign aims to address five key areas: the social responsibilities of high street banks; high cost and irresponsible lending; punitive debt recovery methods; the failing Social Fund; and the promotion of credit unions and other community finance initiatives." (http://www.church-poverty.org.uk/high_cost_credit.htm)

men using high pressure sales tactics and doorstep sales and collection, can emerge and compete in areas where banks would not be able to apply their specific rational and automated forms of credit extension. A whole shadow economy may emerge. For a long time the Church Action on Poverty's National Policy Forum in the *UK* has been investigating practices involving doorstep credit and predatory lending at usurious interest rates. It seems that the situation in the *UK* is rather unusual in Europe, and at present, considerable efforts are being made to deal with it by looking at the measures that are in place on the continent.

High cost credit leads to the further exclusion of poor people from high street bank credit. High cost credit cannot be sold over the same counter as low cost credit. It results from advertising and targeting. While high cost credit provides access, low cost credit provides cheapness because wider access is not offered. Advertising for high cost credit targets groups such as single mothers, housewives and overindebted persons while low cost credit targets the needs of well-off citizens. Credit institutions competing for well-off consumers cannot afford predatory lending because it seems to be extremely difficult to bring the right message to the right target group, when both are addressed simultaneously. This is why in the *UK* for example the market is already totally segmented according to target groups. The exclusion rate from high street banking in the *UK* is more than 15% while on the continent it is below 3%. This creates a target group for predatory lending by uncontrolled, less skilled high cost, relatively small institutions.

Historically, all countries have tried to cope with such vicious circles into poverty by rate ceilings, prohibition of credit extension or limitations on the overall lifetime of a credit. They have resumed the once abandoned price control on interest rates of the 19th century and given it a new philosophy: instead of hostility to credit and its supposed exploitative effects on labour it is now market failure for the weakest consumers which rule cost limitations.

As the burden of credit for weak consumers consists of all payments, consumers have to pay within the monthly period irrespective of whether payments have to be made in the form of interest, fees, and prices for add-on services or for the repayment of the principal. There are four ways of capping these costs:

- General limitations on the size of the instalment and the debt burden
- Interest rate caps
- Direct or indirect limitations on fees
- Limitations on cost burdens in case of default

II.A.3.b) Responsible Lending

In its Proposal for a new Consumer Credit Directive the EU has chosen the first approach by introducing the principle of “responsible lending” in art. 9:

Where the creditor concludes a credit agreement or surety agreement or increases the total amount of credit or the amount guaranteed, he is assumed to have previously assessed, by any means at his disposal, whether the consumer and, where appropriate, the guarantor can reasonably be expected to discharge their obligations under the agreement.

This approach is well-known and has been discussed in nearly all Member States under various headings, such as “improvident credit extension” (*UK*), “immoral overburdening with debts” (“sittewidrige Überschuldung”, *Germany*), “reckless lending”. But only *Sweden* seems to have an explicit regulation in its national law.

According to this regulation, the creditor must always thoroughly investigate the debtor's creditworthiness. This investigation covers financial situation, property, assets, income etc. Provisions to this effect are contained in the Consumer Credit Act (Konsumentkreditlagen) and in the general advice related to it. Another provision is in section 13(2) of the Banking Act (Bankrörelselagen 1987:617), which prescribes that credit may not be extended if the debtor cannot be expected to repay it and is unable to provide the required security.

In the 1990s, the Swedish Supreme Court held that only in exceptional cases can deficient investigation of creditworthiness give the right to adjust or eliminate the debt. Similar cases were settled in *Germany* in the eighties by courts of appeal using “good morals” to free debtors from obligations arising from improvident credit extension.

In *Belgium*, the judge has the right to waive interest if credit has been extended improvidently, a sanction which has been applied on many occasions.

In *Denmark*, the issue is widely discussed but there is no case law. In all other countries there is no legislation in support of this.

Italy highlights the responsibility of banks towards other creditors if they lend to overindebted persons thus creating an image of solvency which may harm others. The same is written into the *French* bank law and is also part of common law doctrines as well as *German* law. This principle of creditor discrimination is of some importance in business loans but fairly unknown in consumer credit. It has therefore no impact on the prevention of overindebtedness. In consumer credit the refinancing of debts for consumers in trouble is well-known and often seen as a positive act rather than creditor discrimination.

The responsible lending approach is in some ways also dangerous because it may raise the rate of exclusion from high street banking and create a shadow market in which "responsibility" may be defined differently. This is why the *UK* is discussing "Access to Credit" much more broadly than improvident credit extension. The question, whether a credit may be repayable in the future, is a core question in banking in general and any standardised legal answer to it, especially by unskilled judges, may have adverse effects.

II.A.3.c) Usury and Rate Ceilings

Traditionally, there are five different systems of regulating high interest rates in credit contracts⁹² in a market society:

- The traditional 19th century **individual usury** prescriptions which still exist in all national laws, mostly in penal law, but also in private law, making the exploitation of a particularly weak position of a borrower a punishable offence. It presupposes ill intention, knowledge of the situation of the debtor and its active exploitation through exorbitant interest rates. These regulations are nowhere applied to commercial consumer credit which addresses an undefined target group with predefined interest rates and thus escapes the definition of "exploitation".
- The **credit discouragement rates** in force in the fifties of the last century fixed by the central banks to curtail credit extension to consumers. These were all abolished by 1990 and are no longer in force. (*Greece, Luxembourg, Germany, Italy*)
- The concept of "social usury", "**market failure**" or the "cartel" approach defined by the courts in *Germany* which assume that APRs, which with reference to the Roman law principle of *laesio enormis* (still part of the Austrian and Italian civil codes) hold

⁹² For a European overview, see *Domont-Naert, F./Lacoste, A.-C.*: Etude sur le Problème de l'Usure dans certains États Membres de l'Espace Économique Européen, Louvain-la-Neuve 1997, Contrat No. AO-2600/96/000260.

that the double of the average ("laesio enormis") express the lack of freedom of contract and a general exploitation of a weak consumer position which presumes a general intention to misuse market failure. This principle is applied through the general principle of good morals. The *Dutch* system comes close to it in so far as the rates are fixed by law in relation to market rates.

- Administratively set **interest rate ceilings** in *France* (Bank of France), *Italy* (Ministry of Economics) and *Belgium* (Royal Decree) which follow the market approach but fix the rate in relation to the kind of credit, amount and lifetime more individually than is achieved under the *German* system.
- **Special rate ceilings** to promote or suppress certain forms of credit such as the limits for overdraft credit in *Spain* (3.5 above the legal rate), for non-bank credit in *Greece* and *Portugal*, for pawnshops in *Germany* (12%), a special low rate for small business loans in *France* (7%) or by special licensing money-lenders (23%) and Credit Unions (12%) in *Ireland*.

The rate ceilings in all systems are related to the APR as disclosed in the contract. In so far as the APR regulations of the Consumer Credit Directive directly influence usury rates in the Member States, defining for example, whether insurance premiums have to be considered in respect of the usury ceiling or not.

The present legal maximum in regulated economies is approximately 20% p.a., while the average interest rate for instalment credit is at present between 7 and 10%, with small variations.

Table 14: Usury Rates and Rate Ceilings (IV.2003)

Member State	Maximum Rates in Consumer Credit	Average Interest Rate (estim.)	Comments
Austria	no	6.5%	There is a Usury Law in Austria but there is no relevant jurisdiction on usury interests.
Belgium	11-25.5%		Maximum rates vary according to the type of credit, the amount and the term. The maximum TAEG authorised by law is currently set at 25.5%; it applies to instalment loan agreements for less than 500 euros repayable over a maximum of 12 months. The lowest authorised maximum TAEG is currently set at 11%; it applies to hire purchase agreements for more than 10,000 euros repayable over more than 48 months.
Denmark	no		
Finland	no		Penal Code 36:6 forbids usury; a court can stop excessively high rates. Interest rates of over 26% seem not to be too high.
France	10.8%-22.08%	10%	The maximum rate (usury rate) is equal to the average rate applied plus 33.33% fixed by the Bank of France. At the 1st quarter of 2003: 22.08% for loans of less than or equal to 1,524

			euros; 17.64% for overdrafts, permanent credit and loans of more than 1,524 euros; 10.80% for personal loans of more than 1,524 euros
Germany	20.76%	10.38	Double the average instalment credit rate surveyed by the Central Bank.
Great Britain	no		The rate of interest in a regulated consumer credit agreement is subject to judicial interpretation of an "extortionate credit bargain" in accordance with consumer credit protection legislation. In practice, interest rates of even 600% have not been prohibited. Credit card credit may have interest rates up to 28%.
Greece	no		Greece abandoned the system of setting limits by administrative provisions in 1989. Hence bank interest rates are free. But there are limits on non-bank credit.
Ireland	no		S.47 of the Consumer Credit Act 1995 gives the right to apply to the Circuit Court for a declaration that the total cost of credit in the agreement is excessive (but see special credit).
Italy	15.81	8%	Half above the average rate set by Ministry of Economics following advice from the Central Bank.
Luxembourg	no	6.5%	Regulation of 14 October 1963 (maximum interest rate in relation to certain forms of credit was repealed by the Law of 9 August 1993).
Netherlands	24%	8.5%	This maximum is calculated by adding 17% to the legal interest rate, the non contractual interest in case of default (7% in April 2003); Maximum permitted effective annual rate: 0 € to 2,500 € = 29,1%; 2,500 € to 5,000 € = 23,0%; 5,000 € to 10,000 € = 19,3%; 10,000 € to 15,000 € = 17,8%; 15,000 € to 20,000 € = 17,3%; 20,000 € to 30,000 € = 16,9%; 30,000 € to 50,000 € = 16,5% (01-01-2000).
Portugal	no		Usury (art. 1146) and usury rates (art. 559-A) identify annual interest rates exceeding legal rates by 3% or 5%, depending on whether or not the loan contract involves security. These provisions are not applied in practice.
Spain	partly	9%	For current account overdraft only (written or unwritten, but not linked to bank credit cards), the APR cannot exceed 2.5 times the legal interest rate.
Sweden	no		There are no fixed maximum interest rates, but there are sanctions on usury which preclude very high interest rates. For interest rate to be determined as usury, however, it must be extremely high.

Regarding the factual cost of credit in each country and especially with regard to the problem of high cost credit, the absence of usury ceilings does not necessarily imply that these countries have an identical market. Especially in *Scandinavian* countries the reporters were astonished that the relatively limited range of interest rates did not comply with the relevant regulations.

The way bank supervision works and especially the extent to which supervised banks service the whole market play an important role.

The *Dutch* report, for example, refers to the standard of a “good banker” in Dutch supervisory law, a provision providing sufficient power to prevent irresponsible lending by banks.

Another important element is the way usury rates are enforced. There is a variety of sanctions available, both in public and in private law. Penalties (*France, Belgium*) or the revocation of the licence (*Ireland*) may accompany civil law sanctions. These sanctions all provide that the consumer can retain the capital as agreed and repay it in instalments. While *Germany* and *Belgium* give free credit, *Greece, France* and the *Netherlands* reduce the cost of the credit to the maximum rate only. *Italy* repays the interest to the consumer but upholds the other terms of the credit.

Table 15: Sanctions for Usury Rates

Member State	Sanction
Belgium	No cost can be charged, debtor retains the benefit of staggered payments, + penalty.
France	Excessive interest is void. Penalty of 2 years in prison and a fine of 45,000 euros.
Germany	No costs can be charged. Contracts are void. No costs, retains the benefit of the credit.
Greece	Excessive interest cannot be charged (abusive).
Ireland	Adjustment by the judge. Defining a fair sum, nullifying the contract, altering the terms of the agreement, revoking licence.
Italy	No interest can be charged.
Netherlands	Excessive interest cannot be charged.

II.A.3.d) Disclosure of Hidden Costs

The EU regulation on the Annual Percentage Rate of Charge has largely contributed to making hidden costs accessible to usury legislation. In *Germany* for example, the courts discussed for a long time whether insurance premiums and broker fees should be taken into account when comparing a usurious credit with an average market rate credit. When the EU Directive was transposed into national law the courts then used the solutions of the Directive by including broker fees into the APR and excluding insurance premiums from the usury definition.⁹³

Whereas prior to this regulation the courts were often not able to assess the true costs of a credit, modern disclosure laws have helped to indicate a parameter, that in comparison to average credit costs of contracts which do not contain hidden cost elements, could be characterised as usurious.

93 Before this legislation the Supreme Court had ruled that insurance premiums had to be recognised by half of their value. The new proposal will certainly again change this jurisprudence because it proposes to include all premiums of insurance contracted at the time the credit was contracted.

The EU regulation which has been literally transposed into all national legislation since is rather strict in its rules on cost disclosure and its inclusion into the APR.

Article 1A of Directive 98/7/EC, amending the Consumer Credit Directive 87/102/EEC, has a broad definition of credit costs. It includes "all commitments (loans, repayments and charges), future or existing, agreed by the creditor and the borrower" in the APR definition.

Art. 1 d) of the Directive 90/88/EEC, amending the Consumer Credit Directive, defined that

"the 'total cost of the credit to the consumer' means all the costs, including interest and other charges, which the consumer has to pay for the credit. (as amended by 90/88/EEC of 22.02.1990)

While in the meantime there is no doubt that the costs of acquisition have to be incorporated while costs occurring only in default are excluded. In particular, the new forms of "linked transactions", where lenders charge costs for services which are somehow linked to the credit contract but seem to have an individual separate counter-value, create significant problems.

The present Directive therefore provides for a complicated system of exclusions and inclusions giving considerable discretion to the Member States and also scope for ingenious lenders to circumvent it. This is particularly true in the case of insurance premiums which in the meantime account for up to 30% of credit costs⁹⁴, account charges and such linked transactions, where repayments are channelled into a savings product which has a lower return than repayment would have had in the credit contract, have been addressed in the new Proposal of the Consumer Credit Directive.

Table 16: Listing of Exemptions in the Directive

Charges/Products	Negative List	(hidden) Positive List
Default charges	charges for non compliance	Charges for compliance
Linked transactions	pay whether the transaction is paid in cash or by credit	pay only with financed transactions
Account charges	transfer of funds and charges for keeping an account intended to receive payments towards the reimbursement of the credit the payment of interest and other charges	(1) (charges where) the consumer does not have reasonable freedom of choice in the matter and where such charges are abnormally high (2) charges for collection of such reimbursements or payments
Membership fees	(iv) membership subscriptions to associations or groups and arising from agreements separate from the credit agreement, even though such subscriptions have an effect on the	

94 For an empirical legal study covering five European Member States, see Reifner, U.: Harmonisation of Cost Elements of the Annual Percentage Rate of Charge, APR, Hamburg 1998, Project No. AO-2600/97/000169

	credit terms	
Insurance premiums	(other) charges for insurance or guarantees (if not exempted)	(payment protection insurance) death, invalidity, illness or unemployment of the consumer, a) of a sum equal to or less than the total amount of the credit together with relevant interest and other charges b) which have to be imposed by the creditor as a condition for credit being granted.

In particular overindebted consumers are burdened with such costs because they are mostly in a weak position, need refinancing and will sign any additional agreement simply to get the desired credit. This is why the clarification on these issues in the new Proposal is of enormous importance for the prevention of overindebtedness. Not only does it have a direct effect on the extension of usury laws in the Member States onto these cost elements but it also makes the true burden apparent.

Belgium will be the first to react when, from June 2003, each consumer credit contract will have to incorporate a statement to the effect that insurance in respect of the outstanding balance is not compulsory and that the consumer may cancel it during the first month.

The EU Proposal now includes all linked insurance premiums regardless of whether they had been contracted "voluntarily" and demands that the diversion of repayments into a separate investment product should either be neutral to the overall costs or incorporated into the APR calculation.⁹⁵

This will make such hidden costs unattractive to suppliers because they will no longer be able to disclose attractive interest rates for their credit and will receive only the return from linked products which are sold by either a third institution which pays high sums to the bank or which is distributed by subsidiaries, as is presently the case.

This effect had indeed already been felt in *France, Spain, and Belgium* where the governments supported such an interpretation already within the wording of the old directive, while *Germany, the Netherlands* and the *UK* were of the opposite opinion. "Voluntarily" is therefore still viewed differently: legal obligation or factual coercion.

The Proposal also addresses the problem of combined products where a savings or investment product is linked to the credit contract and the debtor is obliged to pay into the investment product.

⁹⁵ Art. 12 alinea 2 of the proposal reads: "Costs relating to insurance premiums shall be included in the total cost of the credit if the insurance is taken out when the credit agreement is concluded."

Art. 12 no.7 of the Proposal provides that “where a credit agreement provides for a prior or simultaneous constitution of savings and the borrowing rate is set in relation to these savings, the annual percentage rate of charge shall be calculated in accordance with the procedure set out in Annex III.” This procedure ensures that a lower borrowing rate for the investment product than the borrowing rate for the credit product is recognised in the general APR.

The advantage of uniform and inclusive APR disclosure may perhaps be threatened by the introduction of a new “total lending rate” which, according to art. 2 j) of the Proposal, “means the sums levied by the creditor expressed as an annual percentage of the total amount of credit” ignoring the other linked cost elements which the consumer has to pay.

National courts will be tempted to apply usury only to the “bank rate” because this is the rate which represents the lender’s direct gain, he being blamed for usury.

II.A.4 Preventive Information

Information is a tool for rational activity. Without the opportunity to act and thus to use such information there is no need for consumer information. Studies on consumer information⁹⁶ have revealed that consumers do not ask for information if they are neither forced to act by their present situation nor see how they can use this information.

This is why there are basically two ways to reach overindebted consumers:

- information on consumer rights
- information on a proper choice

Information relating to legal rights includes information on consumers’ rights upon conclusion of an agreement as well as on the rights in the event of default. It is precisely those consumers whose education is limited who are frequently intimidated by the idea of enforcing their rights, because they simply do not know what steps they need to take.⁹⁷ However, merely informing consumers of their rights at the time of conclusion of the agreement does not mean that they will be able to exercise those rights when the time comes and they actually need to do so. This may be be-

96 See *Kind, S.*: cf. footnote 38; *Reifner, U./Volkmer, M.*: Neue Formen der Verbraucherrechtsberatung, Campus: Frankfurt a.M. 1988, p 70 ff; *Julander*: Evaluation of Consumer Information, in: Proceedings of the Second Workshop on Consumer Action Research, Vol. I, Science Center Berlin I/1975-3

97 *Whitford, W.C.*: cf. footnote 60, p 262

cause it is uncertain that they will even remember the rights about which they were informed when they entered into the agreement. In addition, other psychological barriers frequently intervene, such as inexperience with written documentation, or a feeling of being (morally) bound.⁹⁸ It is therefore desirable for consumers not only to be informed of their rights, but also for the exercise of those rights to be simplified and for them to be provided with information about available legal redress and extra-judicial procedures for the enforcement of their rights. Information about legal rights without access to legal advice is therefore no adequate remedy for weak consumers. This insight is not specific to questions of over-indebtedness but of general concern. Access to justice as it has been largely studied in the seventies⁹⁹ is therefore dependant on access to legal advice. Art. 12 no.1 c) of Directive 1987/102/EEC therefore required that Member States should "... provide relevant *information or advice* to consumers".

This is retained in art. 28 no. 2 b) of the new Proposal. In addition, art. 6 is entitled: "Exchange of information in advance and duty to provide advice", although the text of the article refers only to information and not directly to advice. With the introduction of bankruptcy procedures national law has provided institutions for legal advice for overindebted persons, which will be dealt with later in this report.¹⁰⁰ The general access to legal advice is not a question of contract law, although it is one of its foundations in consumer protection. Contract law can only oblige suppliers to give adequate advice, which is incorporated into their duties of product

98 L.c., p 223

99 See the four volumes of *Cappelletti, M. (ed): Access to Justice and the Welfare State*, Alphen aan den Rijn [u.a.]: Sijthoff [u.a.] 1981. This has been followed up by a number of EU activities: see Green Paper on access of consumers to justice and the settlement of consumer disputes in the single market (COM(93) 576). Directive 98/27/EC on injunctions for the protection of consumers' interests (OJ 1998 L166/51); **1996** Action plan on consumer access to justice and the settlement of consumer disputes in the internal market (COM(96) 13); **1998** Communication on the out-of-court settlement of consumer disputes (COM(98) 198); Council Recommendation on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes (98/257/EC). **2001** Recommendation on the principles for out-of-court bodies involved in the consensual resolution of consumer disputes (OJ 2001 L109/56). A network of national clearing houses, the EEJ-NET, and a parallel organisation for financial disputes exists for financial disputes (FIN-NET). See Green Paper on Consumer Protection (COM(2001) 531) and the follow-up Communication COM(2002) 289. The Commission's Consumer Policy Strategy **2002-2006** document COM(2002) 208 has the effective enforcement of consumer protection rules as one of its three objectives. This suggests a number of specific measures and also links to the Green Paper on alternative dispute resolution in civil and commercial law (COM(2002) 196). Although wider than consumer law, it is interesting that the consumer model of establishing minimum criteria is suggested as a possible model for civil and commercial law more generally. A Communication is promised in the near future on online dispute resolution.

100 Subchapter II.E



information and responsible lending as discussed below. It is questionable, whether legal advice through lenders is adequate. Legal advice is part of conflict resolution between opposing parties and it does not seem appropriate to order one party to inform the other about its weapons in this actual or future dispute.

Contract law on consumer credit has therefore developed only one important means of information about consumer rights, which is prescribed in detail in its wording in the doorstep directive and the distance marketing directive to which art. 6 no. 2 h) and nos. 10 and 11 of the new Proposal refer, namely the information about the right of withdrawal which most national consumer credit legislation has incorporated. The study will deal with its effectiveness for the prevention of overindebtedness in the context of the general duty of information.

An important element in the prevention of overindebtedness is the consumer's decision as to which product he wants to buy. This decision, which is made concrete in a contract agreed by the parties concerned, has three dimensions. Two of them concern the use of competition, while the last relates directly to overindebtedness:

The consumer has to obtain

- the best product for the intended use of the capital in terms of amount, time, allocation and price on the market;
- the product most suited to his income and future liquidity risks.

Traditionally, consumer protection legislation has focused on the first requirement of homo oeconomicus outlined by the famous John F. Kennedy consumer rights charta designed on 15 March 1962. Kennedy's Bill of Rights included the right to: safety, information, choice among a variety of products and services at competitive prices, and a fair hearing by governments in the formulation of consumer policy.

Three of these goals: information, choice, and price are in line with the best product approach. Safety as a special goal already went beyond market mechanisms. It is an absolute consumer right irrespective of his own choice. Also irrational and uninformed consumers have a right to safety, because a society with a concern for the collective good would not tolerate that safety as such is for sale. This idea also fits with consumer credit and overindebted-

ness and seems to be addressed directly in art. 153 alinea 1 of the Treaty of Amsterdam:¹⁰¹

"In order to promote the interests of consumers and to ensure a high level of consumer protection, the Community 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 to safeguard their interests."

"Health, safety and economic interest of consumers" are put alongside the rights to information, education and organisation.¹⁰²

The economic interest of consumers is therefore a general goal, which has to be achieved not only by the consumer himself but also through adequate products, obligations to care, state support and mechanisms, which guarantee a financially sound basis without an overload of debts as a precondition for participation in consumer and labour markets as well as in the political process.

But in practice, the EU legislation and most national legislation on consumer protection has not yet recognised this dimension. It thus reflects the fact that legislation always lags behind social developments.

Most rules start from the assumption that the optimisation of rational choice would cure most of those evils that may stem from financial products. To a certain degree this even holds true. Better products at less cost will be less likely to burden the consumer in the future than products which do not satisfy needs. They will make additional credit necessary or will be so costly that the future burden will be increased. This is why a rational choice from among different offers is also a good foundation for social protection.

But it has no **direct** impact on overindebtedness. A consumer who takes out too much of "good" and "cheap" credit may still be threatened by overindebtedness, and even more so than a con-

101 Art. 95 alinea 3 puts again health, security, environmental and consumer protection into the same category and thus consumer protection on equal footing with elements of social protection; see also Art. 87 alinea 2 (a) (cartel exemption for social subsidies to single consumers).

102 It seems to be too narrow if the Commission refers to consumer protection in financial services only with the second part of the definition, when it says on its website for financial services: "Financial services is an area where it is difficult for consumers to make well-informed decisions, about which they can feel confident: The 'products' and services are intangible, and often complex. Consumers buy them relatively rarely, thus making it difficult to learn from experience. The effect of the 'product' may not be apparent for many years (e.g. a life assurance policy or pension)."
http://europa.eu.int/comm/consumers/cons_int/fina_serv/index_en.htm
 Overindebtedness is an issue of consumer protection and not only an issue of social policy as it is proved by the enormous effort DG SANCO has invested to regard these elements in its new proposal on consumer credit.

sumer who takes out less but more expensive credit. The focus on choice and market comparison, as is apparent in all major surveys on consumer credit, offered by test organisations who concentrate equally on interest rates but omit access, amount of advice given to the consumer, reaction in cases of financial crisis and default situation, deters even vulnerable consumers from those elements of a credit product which will threaten them most in the future.

In the following overview of national legislation for consumer information on consumer credit we will therefore focus on such information as relates directly to the effects the credit has on income and liquidity, to future risks and to default.

This information fulfils the following functions for overindebtedness:

- **Reflection:** Consumers may thoughtlessly, too quickly ("cooling off") and without reference to the relevant information ("form and effectiveness of information") make potentially harmful credit arrangements in difficult situations ("doorstep sales", "family environment") and thus unconsciously run into debt.
- **Debt Burden:** Consumers may not recognise the effects of credit on their liquidity in terms of amount and time ("amortisation tables", information on own income and expenditures).
- **Default:** Consumers may not choose products with adequate risk allocation with regard to their own liquidity risks ("combined products"). They may not look at default conditions ("disclosure of default rate", "cost of debt collection") and they may not think how to continue unpaid debts after a contract has terminated ("amortisation time and contract lifetime). Finally, they will not consider the consequences securities will have on their family (guarantees, wage assignments, reservation of property, mortgages).

Much of this regulation is already standardised through Directive 87/102/EEC and its different amendments on cost disclosure which will be further developed by the new Proposal.

The following table indicates that national legislation still has additional information obligations.

Table 17: More Information in National Legislation than Directive 87/102/EEC

Member State	"Does your country have more informational duties than prescribed in Article 4 of the EU Directive on Consumer Credit (87/102/EEC) especially concerning warnings?"
Austria	None, except those mentioned in the Consumer Protection Law § 25 obligations of notification to spouses in credit contracts, and § 25b, c credit commitments of consumers and joint debtor liability.
Belgium	The loan offer (from 1/6/2003: the agreement) contains compulsory information, some of

	<p>which must be given in the form of separate clauses in bold letters. These are:</p> <ol style="list-style-type: none"> 1. "Never sign a contract which has not been completed." 2. A statement to the effect that insurance in respect of the outstanding balance is not compulsory, and that the consumer may cancel it during the first month (new legislation). 3. "The consumer may not sign either a bill of exchange or a promissory note promising or guaranteeing payment of liabilities arising under the loan agreement. Nor may the consumer sign cheques guaranteeing liabilities arising under a loan agreement." 4. "Apart from the agreed TAEG, the consumer cannot be required to pay any additional fees than those expressly agreed, with the exception of agreed sums payable in the event of failure to fulfil the agreement." 5. A statement in relation to retention of title. 6. The text of Article 18 in relation to the cooling-off period.
Denmark	The requirements go further than those in the directive and may to some extent be interpreted as (indirect) warnings; i.e. no 5: the payment plan, including the size and date of each instalment to be paid.
Finland	Duties, not prescribed in Article 4: the consumer credit agreement shall state the limit of the credit, if any; the right to pay the credit before maturity and the determination of the compensation therefore, if any. The law does not mention any warnings.
France	In addition, home loans at fixed interest must be accompanied by a repayment schedule with details of the split as to interest and capital applicable to each repayment.
Germany	<p>Rights to information which go beyond the named EU Directive are:</p> <ol style="list-style-type: none"> 1) Information as to rights: §§ 495, 355 BGB (or § 7 VerbrKrG) include a right of withdrawal and prescribe the form to be advised of that right in the deed. 2) Information as to price and costs: The net credit amount must be stated (§ 492, para.1 no.1 BGB or § 4, para.1 VerbrKrG). According to § 491, para.2 no.1 BGB (or § 3, para.1 no.1 VerbrKrG) the legal definition is given as the actual amount of credit paid to the consumer. This clarifies to consumers the common practice of deducting some of the costs and fees from the amount of the loan before it is paid over. The credit net amount enables consumers to compare the amount they have to repay with the amount they actually receive. The difference between the total amount of the instalments to be paid and the credit net amount corresponds to the total amount paid by consumers for credit. However, this tells consumers nothing at all about the actual commitment they are taking on in relation to
Great Britain	
Greece	<ol style="list-style-type: none"> 1. Unfortunately, the Greek legislator (as referred above, in the JD F1 983/1991) did not make use of the possibility to provide more informational duties than prescribed in art.4 OF EU Directive on Consumer Credit. Art.9 of this JD has more or less adopted the wording of the EU Directive. Moreover, the Greek legislator has not provided as a duty of the creditor to warn the consumer on the risks related to eventual default payment and the incurring charges. 2. Nevertheless, the recent Act of the Governor of the Bank of Greece (Act Nr 2501/31.10.2002 being valid from 1.1.2003 - Official Journal A' 227/28.11.2002) provides for the obligation of the creditors to give additional information to consumers. In particular, this Act introduces the following obligations of creditors: <ul style="list-style-type: none"> - to properly inform the clients about the nature and characteristics of the products and services offered by the bank, as well as the conditions by which bank transactions are ruled (art. A) - to periodically inform the clients
Ireland	<p>The specific warnings that must be provided under the Consumer Credit Act 1995 over and above the informational requirements in Article 4 of Directive 87/102/EEC (as amended) are as follows:</p> <ul style="list-style-type: none"> - Credit agreements Notice of a 10 day cooling-off period must be provided in a credit agreement (excluding overdrafts, credit card and housing loans) though this right can be signed away by a consumer (30(2)) - Housing loans "WARNING – YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP PAYMENTS ON A MORTGAGE OR ANY OTHER LOAN SECURED ON IT. THE PAYMENT RATES ON THIS HOUSING LOAN MAY BE ADJUSTED BY THE LENDER FROM TIME TO TIME" (Section 128) - Endowment mortgages "WARNING – THERE IS NO GUARANTEE THAT THE PROCEEDS OF THE INSURANCE POLICY WILL BE SUFFICIENT TO REPAY THE LOAN IN FULL WHEN IT BECOMES DUE FOR REPAYMENT"
Italy	See art. 124 par. 2 (f-g): under Italian law, there is a duty to disclose guaranties and insurances which the consumer has to provide.
Luxembourg	No, the Directive is applied as it is.
Netherlands	Yes

Portugal	No
Spain	No, the Spanish Directive on Consumer Credit was passed under the mandate of Directive 87/102; as the Spanish Law is from 1995, it also absorbed the modification made to the Directive of 1990 (Directive 98/88). And the obligations regarding information of the Spanish law repeat those of the Directive.
Sweden	No

II.A.4.a) Information Channels: Time, Form and Lieu

Consumers who take credit need time for reflection and information in a form which can be taken away and shown to possible advisers in an environment which facilitates rational behaviour.

II.A.4.a)(1) Time for Reflection

Art. 4 para. 2 of Directive 87/102/EEC required only that the information provided had to be incorporated into the contractual documentation. Art. 6 of the new draft Directive envisages a prior duty on both parties to provide information and advice: "The consumer shall receive this information on paper or on another durable medium **before the conclusion** of the credit agreement."

It still does not specify precisely how long before conclusion this should happen. The time should be stated and measured according to the need for advice on the terms and conditions offered.

The new Voluntary Code of Conduct on pre-contractual information in relation to home loans¹⁰³, whose application is only recommended by the Commission¹⁰⁴, distinguishes between initial information, distributed by lenders to prospective borrowers at the time of the first contact, and the European Standardised Leaflet itself, which should be handed out to the borrower in the course of actual loan discussions. The potential borrower's need for information becomes more specific and more pressing between the preliminary information phase and actual contractual discussions.¹⁰⁵ It would be even better to define specifically the point at which the different levels of information should be given to the consumer. Thus, for example, the preliminary information should at least be offered to consumers at the point of contact, irrespective of whether this is made in person, by telephone or other form of distance communication, and the European Standardised Leaflet should be handed out at the latest following the initial advisory discussions, in which the borrower has stated that he is interested in taking out a secured loan from the specific credit institution.

¹⁰³ See text: http://europa.eu.int/comm/internal_market/en/finances/consumer/homeloans.htm.

¹⁰⁴ See text: http://europa.eu.int/comm/internal_market/en/finances/consumer/homeloans.htm.

¹⁰⁵ *Kemper, R.*: cf. footnote 56, p 177 f

At national level, different models are in force mostly relating to financial services other than the credit which could be used.

In *France*, lenders must send a written offer by post, free of charge to prospective borrowers and guarantors (assuming that they are natural persons) in the case of loans secured on real estate, and that offer must contain specified information.¹⁰⁶ The offer cannot be accepted by the prospective borrower before the expiry of 10 days following receipt of the offer.¹⁰⁷ Consumers are thus compelled to have a cooling-off period. This procedure is feasible at least in relation to larger loans; it is less desirable for smaller amounts because of the resulting delays in delivery of the goods purchased. It also entails a certain amount of coercion of consumers. However, where loans are secured by a charge over land, which are in any case subject to some delay because of the various formalities involved, a compulsory cooling-off period could force consumers to consider the seriousness of their decision and encourage them to make careful product comparisons. This could prevent impulsive borrowing and thereby potential overindebtedness through making premature commitments.

Since the "MURCEF Law"¹⁰⁸ was passed, it has been compulsory to provide consumers with written terms and conditions when they open an account and any changes must be notified three months before they come into effect. Simply displaying the general terms and conditions in the credit institution concerned no longer suffices.

The duties of life insurance providers in *Great Britain* go much further. They must make "Key Features" available to consumers prior to conclusion of the agreement and, where distance selling is involved, the documents must be sent to consumers within five working days. These "Key Features" were drafted by the Financial Services Authority.¹⁰⁹ Every insurance company must use the same format. The objective is to enhance competition by improving product comparability, but at the same time there is an explicit attempt to assist consumers to gain an improved knowledge of the product and to ensure that it is possible to compare the products of different companies. In addition to the purely factual contents of the "Key Features", they also include the necessary information about them, frequently in the form of questions and answers. For example, there is an explanation that growth rates represent ex-

106 Code de la Consommation, art. L.312-7, L.312-8

107 *Kemper, R.*: cf. footnote 56, p 227; Code de la Consommation, art. L.312-10

108 Act no. 2001-1168 of 11 December 2001

amples only and that they are dependant on future growth. They explain that there is a risk that an insurance agent may highly recommend a product because it pays him the highest commission and they set out the effect of costs on the investment. If these "Key Features" are indeed read by consumers, they promote their level of financial literacy because the statements they contain are simply expressed and understandable to "the man in the street", and they provide information about all significant aspects of life assurance policies.

Art. 6 of the directive on distance marketing of consumer financial services (2002/65/EC) stipulates a cooling-off period of 14 days, in particular on the internet.

"Right of withdrawal: The Member States shall ensure that the consumer shall have a period of 14 calendar days to withdraw from the contract without penalty and without giving any reason. The period for withdrawal shall begin: either from the day of the conclusion of the distance contract or from the day on which the consumer receives the contractual terms and conditions and the information in accordance with Article 5(1) or (2), if that is later than the date referred to in the first indent."

Most Member States have similar reflection periods for all consumer credit contracts such as arts. 495, 355 of the *German Civil Code*.¹¹⁰ But these rights have no serious impact on overindebtedness if they have to be exercised after the capital has been used already. The German code even states that the right of withdrawal will be effective only if the received capital has been returned to the lender.

Psychologically, credit divides into two totally contradictory events, namely the positive experience when the capital is received and can be spent for consumption purposes or the relief of another pressing debt, and the negative experience when the first instalment is due and the prospect of continuous payments looms. This never happens before the first month when the capital is already spent and replaced by items which can be liquidated only with high losses.

The preliminary offer at least gives the chance to visit a credit counsellor or debt advice agency, both of whom are able to simulate future developments and issue warnings. But this possibility

109 http://www.fsa.gov.uk/consumer/shop_around/products_services/mn_insurance_info_get.html.

110 These delays do not limit corresponding national rights. "This paragraph shall be without prejudice to the right to a reflection time to the benefit of the consumers that are resident in those Member States where it exists, at the time of the adoption of this Directive." (art. 6 alinea 3)

is seldom used and then only by those who least need it. Credit and debt advice is usually sought after default.

In social credit schemes such as micro-lending¹¹¹, where the lender has no individual interest in selling credit besides the fact that the borrower is able to support his own business, the system of step-by-step credit has been invented in which each credit starts with a savings period in which the future instalment must be paid before the capital is taken out. This system also applied when mortgage loans first appeared, where housing loans required a pre-savings period. The system enables consumers to experience the future debt burden without the coercion of an already binding credit contract.

II.A.4.a)(1)(a) Right of Withdrawal

Perhaps the most significant information relating to legal rights in consumer protection law is the advice to consumers of their existing right to withdraw from agreements and the period during which that right may be exercised. The right of withdrawal allows consumers to reflect calmly on their decision and to review it if appropriate.

Under consumer credit legislation currently in force at European level, there is no right to withdraw, because the Consumer Credit Directives merely set out a catalogue of demands which leave regulation of the legal consequences to the individual Member States. Most Member States have therefore long since provided for the ability to withdraw from the contract within a specified period without the need to give any reasons.¹¹²

This regulation was therefore also included in the proposed new Consumer Credit Directive.¹¹³ Under art. 11, it envisages a period for withdrawal of 14 calendar days and under art. 6 no. 2 i), consumers must be advised of this in writing on paper or other permanent data carrier.

Other European Directives also provide for time-limited rights of withdrawal about which consumers must be informed, including

- the Directive on distance marketing of consumer financial services¹¹⁴, art. 6: 14 days
- the Directive on door-to-door sales¹¹⁵, art. 5: 7 days

111 See *Reifner, U.*: cf. footnote 78, p 23

112 Reasons given for the proposed new Consumer Credit Directive (COM(2002) 443); finally reasons for art. 11.

113 COM(2002) 443

114 Directive 2002/65/EU

115 Directive 85/577/EEC

- the timeshare Directive¹¹⁶, art. 5 no. 1.1, bullet point 2: 10 days, if correct information about the right of withdrawal is provided, otherwise 3 months
- the Directive on distance marketing¹¹⁷, art. 6 para. 1: 7 days, if the correct caution is given, otherwise 3 months
- the Directive on distance marketing of financial services, art. 3 para. 1 no. 3 letter d also requires that consumers be given practical indications as to how to exercise the right of withdrawal, such as the address to which the notice of withdrawal should be sent
- the third Directive on life insurance¹¹⁸ requires pre-contractual information as to the terms under which the right to withdraw and rescind may be exercised.

Given the multiplicity of withdrawal rights at European level, it would be helpful for consumers, if the periods for withdrawal and its terms were harmonised. However, such harmonisation would not be enough to enable these provisions to contribute to consumers' financial education.

The information as to consumers' rights of withdrawal should instead take into account the reasons why they are rarely exercised in practice.¹¹⁹ There is a considerable risk that withdrawal may be seen as a personal admission of failure and that consumers forego the right as a result.¹²⁰ It is therefore essential that it should be made clear that no particular reason need be given for exercise of the right to withdraw, but that it is completely legitimate to use the period for withdrawal in order to make comparisons with other products. Help should be made available to consumers to exercise the right should they wish to do so without obstruction. Pro forma withdrawal notices may assist this process, as may allow the contract simply to be returned as sufficient notification of withdrawal.

Art. 8 of the first Consumer Credit Directive¹²¹ gave consumers the right to redeem loans early and to receive a corresponding reduction in the total cost of credit. However, European consumer credit legislation still contains no provision for informing consum-

116 Directive 94/47/EU

117 Directive 97/7/EU

118 Directive 92/96/EEC

119 *Reifner, U.*: Abschaffung des § 56 Abs. 1 Nr. 6 GewO?, *Verbraucher und Recht* 1989 p 63 f.; *Schmel, K.-J.*: Verbesserung des Verbraucherschutzes im Konsumentenkreditrecht? (re: § 56 Abs. 1 Nr. 6 GewO, § 1 HWiG, § 7 VerbrKredG), *NJW* 1991 p 1219

120 *Kind, S.*: cf. footnote 38, p 496, 497; *Domont-Naert, F.*: cf. footnote 72, p 189

ers of this right. Annex 1 to 1.2 iv) merely recommends that national legislature should provide for notification of the right of early redemption with a corresponding reduction of the cost of credit.

Art. 10 para. 2 g) of the draft new Consumer Credit Directive¹²² is intended to change this. In addition to the right of early redemption provided by art. 16, this article makes it compulsory to provide information about this right and about the procedure for exercising it.

Further, art. 3, para. 1 no. 3 c) of the Directive relating to distance marketing of consumer financial services¹²³ requires that information be provided to consumers as to their rights to terminate the contract and any attendant penalties under the contract. Similarly, the Voluntary Code of Conduct relating to pre-contractual information for home loans¹²⁴ requires that information as to early redemption, its terms and any costs arising should be given.

As stated above, knowledge of a right is a natural pre-requisite for its exercise. The very consumers whose experience is limited will, however, not be aware that they have the right to repay the loan earlier than anticipated and to receive a proportionate refund of the cost of credit. This is something that may contribute to the prevention of overindebtedness, because it encourages consumers to apply surplus income to repay their debt, so that if they are short of money in the future, less expenditure is required to satisfy the loan. Explanation of this right is accordingly essential and it should be accompanied by encouragement to repay the loan early.

II.A.4.a)(1)(b) Form of Information

Formal requirements are a classic instrument for reminding prospective parties to contracts of the significance of and risks involved in their decision and for warning them against rushing into an agreement.¹²⁵ Formalities enhance other rights to information by preserving their contents, by evidencing them and by making them accessible at any time.¹²⁶ They enable consumers to review the contents of agreements during any cooling-off period and, in addition, they make it easier to enforce rights, because their evidential function helps to avoid proceedings and makes any proceedings that are instigated simpler.¹²⁷ Moreover, formalisation of

121 Directive 87/102/EEC

122 COM(2002) 443

123 Directive 2002/65/EEC

124 Part II, vol. 1. no. 8 and European Standardised Leaflet, no. 12

125 *Kemper, R.*: cf. footnote 56, p 220 f; *Heiss, C.*: cf. footnote 38, p 95

126 *Heiss, C.*: cf. footnote 38, p 93

127 *Heiss, C.*: cf. footnote 38, p 95

the act of concluding an agreement has the effect of clearly distinguishing the discussion stage from conclusion of the agreement, so that any outstanding points arising in the course of longer negotiations involving more complex products, such as financial services, can come to light.¹²⁸ However, there is a problem in that these functions become degraded the more often the conclusion of agreements follows a specific format.¹²⁹

The reflection time can be used effectively only if external advice can be obtained. Such external advice needs to be in an easily transferable form because the third person is not present at the time when the conditions have been agreed or offered.

II.A.4.a)(1)(c) Written Form

Traditionally, the written form has always been seen as the appropriate form for warning and proof. It has historically been used for those elements of debts which came from quick and irrational decisions such as guarantees. It is in this regulation that most can be learned about the written form and its historical role in preventing overindebtedness.

Under art. 4 para. 1, sub-para. 1 of the Consumer Credit Directive¹³⁰, credit agreements must be in writing. Consumers must receive a copy of the written agreement. This is a fundamental contractual requirement, and the formality is necessary for the validity of the contract. It does not merely serve the purpose of recording the agreement.¹³¹

The objectives of the written formalities can be achieved only, if a breach is followed by a penalty proportionate to their importance.¹³² The Directive is silent on this point¹³³, leaving the question of penalties to national legislation. Most assume that a contract is void if it lacks the legal form. As many contracts are now recorded in writing, a signature is swiftly obtained and the written formalities do not, as previously¹³⁴, ensure adequate time for reflection.

The written form requires a form on paper, which requirement may be fulfilled by means of computer printouts. At least, as far as contracts are concerned, all legal regulations require hand-writing

128 L.c., p 102

129 L.c., p 96; *Kemper, R.*: cf. footnote 56, p 223

130 Directive 87/102/EEC

131 *Heiss, C.*: cf. footnote 38, p 98

132 L.c., p 96

133 L.c.

134 *Kemper, R.*: cf. footnote 56, p 223

for the signature. *French* contracts even require further hand-written elements, when the signature has always to be accompanied by a hand-written “read and approved”.

Art. 313-7 of the Code de la Consommation similarly requires a hand-written declaration for a guarantee whose wording is prescribed in the law. Failure to observe this requirement renders the guarantee null and void.¹³⁵ It is intended that this will make guarantors aware of the significance of the transaction and the seriousness of the situation.¹³⁶ No deviation from the statutory formulation of the text is permitted.¹³⁷ Guarantors must state that they are prepared to be held liable for a specified amount, for the payments, interest, penalties for breach and interest on arrears should the principal debtor default. The text is kept short, to be written out without taking an inordinate amount of time.¹³⁸ Guarantors are simultaneously given the substantive contents of the guarantee. The extent of their potential liability is made clear, as well as the fact that their entire income and assets are at risk. In addition, having to write out the declaration ensures that guarantors have really taken notice of this information, and it is done without additional cost.

Hand-writing is also used in *France* in instalment purchase, where the borrower waives the right of withdrawal in order to have immediate delivery of the goods purchased (art. 311-24 Code de la Consommation). The waiver must, in addition to the expressed wish to have immediate delivery, contain a declaration as to awareness of the reduction of the period for withdrawal to three days, a maximum of seven days (= the usual period for withdrawal under art. 311-15), ending upon delivery of the goods.¹³⁹ This is a formal requirement which goes beyond the formalities prescribed by European Directives, but in general terms it leads to a restriction on the period for withdrawal which has not hitherto been envisaged by the Consumer Credit Directives and which therefore remains permissible.

In *Belgium*, hand-writing is required to a limited extent in the conclusion of a consumer credit agreement. Consumers must not only

135 *Pétel-Teyssié*: Prêt à intérêt, no. 122

136 *Kemper, R.*: cf. footnote 56, p 223

137 *Pétel-Teyssié*: Prêt à intérêt, no. 122

138 The wording of the original is as follows: “En me portant caution de X..., dans la limite de la somme de ... couvrant le paiement du principal, des intérêts et, le cas échéant, des pénalités ou intérêts de retard et pour la durée de ..., je m’engage à rembourser au prêteur les sommes dues sur mes revenus et mes biens si X... n’y satisfait pas lui-même.”

139 *Pétel-Teyssié*: Prêt à intérêt, no. 109

sign the credit agreement, but also write under their signature the words “read and approved for ... euros on loan¹⁴⁰”.

There are even stricter rules outside the EU. Under *Swiss* law, guarantees above 2,000 Swiss francs must be certified by a notary public in accordance with art.493 II Obligationenrecht (the Law of Obligations). Combined with the warnings and evidential aspects generally associated with formal requirements, the purpose of this provision is to ensure that guarantors receive advice as to their rights.¹⁴¹ However, this does involve additional costs¹⁴², usually borne by the borrower. The extent to which notarisation really ensures that the transaction is explained is also questionable. Certainly, the process should verify that the agreement accords with the actual wishes of the parties¹⁴³, but ultimately it is impossible to explore the basis of those wishes and whether in fact the parties are clear about the possible consequences of a guarantee, with the result that, here too, the educational process is absent.

Art. 1, para. 4 of the Consumer Credit Directive enables Member States to exempt agreements from written formalities and the information requirements of the Consumer Credit Directive where these credit agreements have been notarised or judicially documented.¹⁴⁴

II.A.4.a)(1)(d) Electronic Form

The written form is now challenged by art. 10 of the new consumer credit proposal which will allow that “Credit agreements and surety agreements shall be drawn up on paper *or on another durable medium*.”¹⁴⁵

This form shall also suffice for the pre-contractual information (art. 6 alinea 2), for the opening of overdraft credit (art. 21), for unauthorised overdraft (art. 10 alinea 2 letter g) and for a change in the borrowing rate (art. 14 no. 4). In particular it concerns sensible information on overindebtedness and had up till now been covered by the directives concerning electronic signatures (Directive

140 Art. 17 of the Act of 12 June 1991 in relation to consumer credit: “lu et approuvé pour ... euros à crédit” or “Gelezen en goedgekeurd voof ... euro op krediet”

141 *Hofmeister*: Rechtssicherheit und Verbraucherschutz – Form im nationalen und europäischen Recht, Deutsche Notarzeitschrift 1993, Sonderheft 32, p 43

142 *Kemper, R.*: cf. footnote 56, p 223

143 *Hofmeister*: cf. footnote 141, p 45

144 *L.c.*, p 37

145 Article 3 letter o) defines a “durable medium” as “any instrument which enables the consumer to store information addressed personally to him in a way which makes it accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored.”

1999/93/EC), or already mentioned in the directive on distance marketing of financial services, and has no precursors in national legislation.

This new approach has two different elements: the written form of the information and the hand-written signature.

As far as the information is concerned, the traditional functions of proof and accessibility are equally guaranteed by the electronic medium in the same way as the written form. It even has some advantages, in so far as it can be reproduced, transferred and retrieved at any time and lieu more easily than the written form and can always be transformed into this form through a print out.

Its disadvantage lies in the fact that it has an additional barrier between the information and the receiver. The receiver has to switch on a computer and go to the place where this information is stored. The other aspect is that the sender may still have access to its contents and may be able to change it. These problems can be solved if electronic business makes the print out obligatory.

Much more important is the second element which may devalue what has been achieved regarding rational decisions by consumers in consumer credit contracts through reflection periods and duty of information, namely the hand-written signature in which graphologists will be able to recognise not only the individuality of the signature but also the temper and mood of the individual at the time of signing.¹⁴⁶ It can also be assumed that handwriting makes a psychological impact on the person signing. Hand-written signatures are an important cultural ceremony and appear repeatedly when international contracts and charts are signed in a solemn ceremony or when important guests sign guest book of institutions and towns. The electronic signature, however, is a mouse-click which does not represent the personality of the sender of the message and can always be represented by another person. Before abolishing this symbol, consideration should be given as to whether a hand-written signature, called also an "authentic signature" in *English*, a "persönliche Unterschrift" in *German*, or "une

146 *Dirks, H.*: Die Handschrift - Schlüssel zur Persönlichkeit, Bertelsmann München, Gütersloh, Wien; *Heiss, R.*: Die Deutung der Handschrift, Claasen Verlag Hamburg; *Känzig, R.*: Mensch und Graphologie, Wilhelm Heyne Verlag München; *Katz, G.*: Die Intuition in der Graphologie, Rothenhäusler Verlag Stäfa; *Klages, L.*: Handschrift und Charakter, Bovier Verlag Herbert Grundmann, Bonn; *Knobloch, H.*: Graphologie, Lehrbuch neuer Modelle der Handschriftenanalyse, Econ Verlag Düsseldorf Wien; *Wieser, R.*: Grundriss der Graphologie, Kindler Verlag München (taken from http://grafodate.ch/_alles/litera.htm)

signature à titre personnel¹⁴⁷ in *French*, performs an important warning function as to the responsibility a debtor undertakes when he agrees to a credit offer. This must to be tested before it is abandoned.

II.A.4.a)(1)(e) Standardised Information Sheet

Another way of facilitating the issuing information and warnings is standardisation. Following the U.S. American example on truth-in-lending regulations in a number of countries¹⁴⁸, providers are obliged to use statutory forms of contract. The aim is to improve comparability of products by prescribing that certain minimum items of information can be found at the same place in the contract, thus ensuring that, if contracts are set side by side, they can be compared at a glance.¹⁴⁹ To the extent that it is really universally applied, this form makes it easier, to compare and clarify the various products available.¹⁵⁰

The Voluntary Code of Conduct on the Provision of Pre-contractual Information requires that a form be handed out containing information which is prescribed in detail, namely the "European Standardised Leaflet". This leaflet makes information which is prescribed in detail available in a standardised form at the pre-contractual stage. Item 2 requires a "brief but clear description of the product". It should also be made clear whether the loan is an annuity loan or if it involves amortisation.

In the case of the "offre préalable", prescribed in *France* and *Belgium* in relation to consumer credit, lenders are compelled to make potential borrowers and guarantors (assuming they are a natural person) a binding offer in writing and in duplicate. The lender is bound by this offer for 15 days.¹⁵¹ Unlike under current European law, those providing security are given the same information as the borrowers themselves. The "offre préalable" must contain a number of items of information. In France, this binding offer is subject only to acceptance of the borrower personally¹⁵², which in

147 See *Renard, I.*: Utiliser la Signature Électronique à Titre Personnel: Quels Risques, Quelles Garanties? (<http://www.journaldunet.com/juridique/juridique/020618.shtml>)

148 E.g. France and Belgium

149 *Calais-Auloy*: Le Crédit à la Consommation en France, in: *Hörmann, G.*: cf. footnote 3, p. 108; *Kemper, R.*: cf. footnote 56, p 207; *Bräunig, G.*: Der Konsumentenkredit im französischen Recht, Duncker & Humblot, Berlin 1982, p. 60

150 *Wilhelmsson, T.*: cf. footnote 44, p 82

151 **France**: Code de la Consommation, art. L.311-8; **Belgium**: Act of 12 June in relation to consumer credit, art. 14 § 1; *Calais-Auloy*: cf. footnote 149, p 107 f; *Bräunig, G.*: cf. footnote 149, p 58

152 Code de la Consommation, art. L.311-15; *Calais-Auloy*: cf. footnote 149, p 111; *Pétel-Teyssié*: Prêt à intérêt, no. 105

practice is usually the case.¹⁵³ Acceptance of the “offre préalable” otherwise gives effect to the agreement.¹⁵⁴ In addition to the prescribed form of the contract in France, art. R., 311-6, para. 2 of the Code de la Consommation requires that it be clear and legible and in a minimum of font size 8. This demonstrates that even statutes are able to influence the design of contracts. A compulsory minimum font size is feasible for all contracts and would at least introduce a verifiable minimum standard in terms of clarity of presentation.

However, there is no requirement that the standard form be strictly adhered to. Additional information in the same form and variations in the order in which information is set out are permissible and this can lead to the essential information being lost in excessive amounts of additional voluntary information.¹⁵⁵

Under art. 3 of the timeshare Directive¹⁵⁶, taken in conjunction with its annex, anyone expressing interest in a timeshare must be given a document containing a detailed product description (in this instance primarily a description of the property and the type of timeshare) at the discussion stage. Under art.3, para.2, the information contained in this document forms part of the contract and can be altered only as a result of circumstances beyond the control of the vendor company and only by express reference in the written contract to the alteration.¹⁵⁷ Comprehensive product information must therefore be given at a very early stage. Consumers are accordingly able to rely on the information and have the benefit of certainty for making plans and product comparison. They are also allowed sufficient time to reconsider. Although timeshare ownership is very different in nature from financial services, the manner in which product information is provided is transferable to financial services. Once the amount of credit sought by consumers and the security they are in a position to provide for the loan has been established, lenders are able to provide a binding product description together with its advantages and disadvantages. Nor is there any reason why such information should not be binding upon the eventual agreement. To take the volatility of the financial markets into account, there should be provision for a time limit on the offer.¹⁵⁸

153 *Calais-Auloy*: cf. footnote 149, p 112

154 Code de la Consommation, art. L.311-15

155 *Kemper, R.*: cf. footnote 56, p 206, 207; *Pétel-Teyssié*: Prêt à intérêt, no. 92; *Bräunig, G.*: cf. footnote 149, p 61

156 Directive 94/47/EU

157 *Heiss, C.*: cf. footnote 42, p 101

158 applies also to the “offre préalable” in France and Belgium

Use of standard forms of agreement can thus give consumers a fundamentally improved picture of the information with which they must be provided; in themselves they do not have an educational function. An unqualified requirement that the standardised form be adhered to, together with further explanation of the contents are needed.

Art. 311-15 of the *French Code de la Consommation* also provides for a detachable form in the credit agreement to be used when exercising the right of withdrawal. This relieves consumers of the need to formulate the notice of withdrawal themselves, something which is often difficult for non-lawyers to do. All that consumers have to do is fill out the form, sign it and send it to the lender. The legal technicalities involved in the exercise of a right are also prescribed in other jurisdictions. For example, in *Germany*, § 692, para.1 no.5 *Zivilprozessordnung* (Code of Civil Procedure) contains a form for defending a writ. Existence of such forms lowers the barrier to exercising the right of withdrawal.¹⁵⁹ It is made easier for consumers to exercise their right to withdraw. In *France*, use of the form is not, however, compulsory; consumers may also withdraw from the agreement by writing their own letter, the only requirement being that it must make clear that they wish to withdraw.¹⁶⁰ The form therefore has advantages for consumers only. It makes withdrawal easier and, for less well-educated consumers in particular, it amounts to an improvement in the enforcement of their rights. Addition of a form also suggests to consumers that exercising the right is not unusual, reducing psychological barriers. Nevertheless, it does not have an educational function.

II.A.4.a)(2) Lieu of Conclusion

A bank is not only an institution, but also a building which signals solidity, rationality and trust. Credit taken out in a bank already requires a certain amount of rationality from consumers and protects them from taking unconscious decisions. Where credit is available only from banks, the number of dangerous credit contracts is considerably reduced. This historical insight has been incorporated into national legislation at three levels:

- Consumer loans are mostly a monopoly of banks or similar institutions¹⁶¹
- Credit brokerage in particular is supervised and restricted¹⁶²

¹⁵⁹ *Kemper, R.*: cf. footnote 56, p 376; *Calais-Auloy*: cf. footnote 149, p 110

¹⁶⁰ *Calais-Auloy*: cf. footnote 149, p 110; *Pétel-Teyssié*: *Prêt à intérêt*, no. 111

¹⁶¹ See II.A.1.a) on p 73 ff

¹⁶² See II.A.5.a) on p 135

- Doorstep sales are regulated

II.A.4.a)(2)(a) Doorstep Sales

The EU-Directive on doorstep sales (85/577/EEC) has already addressed the problem that consumers, who have been contacted at home or at their workplace, are under pressure for immediate and irrational decisions. They are unable to make comparisons and are in a captive situation, because they cannot leave the lieu where the seller is operating. This is especially true when credit is sold.

Doorstep credit has therefore historically been seen as a threat to those vulnerable to overindebtedness. This is why most countries have in the past effectively suppressed doorstep credit in one of the above-mentioned ways. According to art. 56 of the 19th century *German* *Gewerbeordnung* (Trade Law), doorstep loans (unlike instalment purchases) were generally forbidden, subject to penalty and supervised by the Trade Authorities. The *German* civil courts applied this interdiction also to civil law, holding it to be part of special consumer protection law applicable to contracts with the same effects as a free credit as in usury law.

In the eighties, the legislator exempted banks from this interdiction for their own efforts which did not lead to a significant activity in this area. Up till now, all other bodies or individuals apart from banks, especially brokers, can neither sell nor solicit loans at the homes or workplaces of consumers. When the doorstep sales directive (85/577/EEC) came into force, *German* courts abolished the free credit sanction because the legislature seemed to have openly favoured a right of withdrawal instead, as outlined above, is not effective in terms of preventing people from running into debt. Thus the EU-Directive indirectly removed an important protection against irrational credit in *Germany*.

The new Proposal for a Consumer Credit Directive intends to remedy these effects. Art. 5 reads:

“The negotiation of a credit or a surety agreement outside business premises in the circumstances referred to in Article 1 of Council Directive 85/577/EEC shall be prohibited.”

This will not only reintroduce but also extend the old interdiction on instalment purchase which has now reached the same proportions as loans, such that even houses are sold at the doorstep.

In *Ireland*, moneylenders (generally involved in doorstep collected credit at high interest rates to consumers with very limited credit options) must specify the interest rates that they are proposing to charge in their applications and, if successful, are bound by the terms of their licence subsequently including the interest rate. Mortgage intermediaries must also have an appointment in writing



from each undertaking for whom they act, but there does not appear to be any obligation to disclose the fact that they may receive a commission.

II.A.4.a)(2)(b) Distance Marketing and the Internet

The internet will present a major challenge to Member States in dealing with improvident credit decisions. Internet banking is indeed doorstep banking, because it happens at the home of the consumer, except that the influence exercised on him is not personal. At present, all Member States do have an effective means against such credit extension through the binding rule that all credit contracts have to be signed in hand-writing by the credit applicant. This is, as discussed above¹⁶³, challenged by the new Proposal for a Consumer Credit Directive. This idea has its roots in the existing Distance Marketing Directive which does not deal with credit and the special problems of overindebtedness in particular.

The Directive relating to distance marketing of consumer financial services¹⁶⁴ emphasises in its preamble that consumers should, by receiving the requisite information, be placed in a position "to properly appraise"¹⁶⁵ the service that best meets their needs.¹⁶⁶ Whether the rights to information provided by the Directive are in fact appropriate to this aim requires investigation. The rights to information relating to distance marketing of consumer financial services are not dependent upon the type of financial service¹⁶⁷ and apply to all financial services agreements concluded through communications at a distance, such as over the Internet, or indeed by post or telephone, and they are comparable with those contained in the Directive relating to door-to-door sales.¹⁶⁸

The Directive regulated internet business where no written form is prescribed. It left the question of form to special legislation. Credit which is paid off by future income should not be treated the same as investment, insurance and payment facilities paid out of existing income or which at least can be terminated at any time. This is why the regulation in the new consumer credit Proposal should be reconsidered.

¹⁶³ See II.A.4.a)(1)(d) on p 121

¹⁶⁴ Directive 2002/65/EU

¹⁶⁵ Preamble to Directive 2002/65/EU, para. 21

¹⁶⁶ Preamble to 2002/65/EU, para. 3

¹⁶⁷ Preamble to Directive 2002/65/EU, para. 20

¹⁶⁸ Directive 85/577/EEC

II.A.4.b) Information on the Debt Burden

The most important information for the prevention of overindebtedness is the information on the debt burden itself. But individuals may have a different understanding of debt burden depending on what assumptions are made. If cash payment would be the solution, the additional costs, expressed in the difference between cash price and credit, should be disclosed. If the repayable debt is too high, the total amount of credit should be disclosed. If, what we assume, the monthly liquidity is the problem, the monthly instalments should be in the centre of information.

II.A.4.b)(1) Cash Price and Total Amount of Debts

In instalment purchases, annex I no. 1.1.2ii of the Consumer Credit Directive¹⁶⁹ recommends that the cash price should be shown against the price of paying by instalments. The intention is to convert this recommendation into a mandatory provision under art. 6 f) of the new draft of the Consumer Credit Directive.

This information, already frequently required under Member States' national legislation¹⁷⁰, will show consumers clearly the difference between the cost of payment in cash and payment by instalments. It could encourage consumers to consider, whether they could manage to purchase the goods they require without resorting to costly credit in circumstances where the difference between the cash price and the price of payment in instalments is particularly great.¹⁷¹

The EU regulations and all national legislation require indication of the "total amount of payments", as defined in art. 4 no. 2 c) of Directive 87/102/EEC or in art. 2 i) of the new Proposal, the "sums levied by the creditor". In *Belgium* too the amount of any deposit due must be stated.¹⁷² However, these rules often do not apply "where not possible", which is largely assumed to be the case in open end and variable rate credit. But this assumption does not hold true in the light of the APR-regulation. If an APR can be indicated then the total expected amount of payments within a given time period can also be indicated.

II.A.4.b)(2) Repayment Plan

169 Directive 87/102/EEC

170 E.g. Belgium: art. 41 no. 1 of the Act of 12 June 1991 in relation to consumer credit; Germany: art. 502 para. 1 no. 1 Civil Code

171 *Whitford, W.C.*: cf. footnote 60, p 203, 204

172 Art. 41 no. 3 of the Act of 12 June 1991 relating to consumer credit

The regulation on the instalments is less clear. Letter c) of art. 4, para.2 of the Consumer Credit Directive¹⁷³ states that the "written agreement shall include a statement of the amount, number and frequency or dates of the payments which the consumer must make to repay the credit, as well as of the payments for interest and other charges; the total amount of these payments should also be indicated where possible."

This information, as it is prescribed in all national legislation, is too abstract for the consumer.

Consumers recognise a future debt burden only in the form of a currency amount repayable in monthly instalments. The same is true for the time-table. They do not know what will happen in 36 months but they may know that in May 2006 their child will finish school or their work will be terminated or their car will have to be renewed. This is why only details of currency amounts and dates provide the necessary information.

Only two European states, *Denmark* with regard to consumer credit and *France* with regard to mortgage loans, have made repayment plans with dates and amounts of payments obligatory. In France, these plans also have to distinguish between amortisation and interest in each instalment. In the other countries, such plans are handed out after the contract has been concluded.

The European Standardised Leaflet prescribed by the Voluntary Code of Conduct on Pre-contractual Information for Home Loans, adherence to which was recommended by the European Commission on 8 December 1987¹⁷⁴, provides at item 14 for the consumer to be given an example of a repayment plan containing the level of instalment payments, the level of interest payments, the capital outstanding, the amount of each instalment and the total capital and interest payable.

Art. 10 alinea 2 of the new consumer credit Proposal also requires:

"c) where capital amortisation is involved, a statement of account in the form of an amortisation table, the payments owing, and the periods and conditions relating to the payment of these amounts; ... The table referred to in c) shall contain a breakdown of each repayment to show capital amortisation, the interest calculated on the basis of the borrowing rate and, where applicable, the additional costs. If, in the case referred to in c), a new drawdown is not possible without the consent of the creditor, the creditor's decision shall be communicated on paper or on another durable me-

173 Directive 87/102/EEC, supplemented by Directive 90/88/EEC

174 87/598/EEC., Official Journal L 365 dated 24/12/1987, p 0072-0076



dium. It shall be made available to the consumer and contain the amended data to which this paragraph refers."

But this information has to be given in the contract only when the debt has already been undertaken. It also excludes amortisation free credit where the payments consist only of interest.

For pre-contractual information art. 6 c) requires only an indication of "the amount, number and frequency of payments to be made".

If such payment plans are to be an effective means of preventing over commitment, they should not only be drawn up in currency units and dates before the contract has been concluded, but should also give the consumer the opportunity to integrate these figures into his/her own liquidity plan for the future.

Such tables are now drawn up in debt advice agencies and for debt rescheduling plans within consumer bankruptcy schemes.¹⁷⁵

As it would be difficult for suppliers to draw up such a cash flow plan for individual households, the only solution would lie in the *French* system of "binding offers" including a repayment table which the consumer could then carry to a debt or credit advice agency which would then draw up a cash flow table for them in the future. With this information, the consumer could renegotiate the amount and dates of repayments and adapt them to foreseeable changes in income and expenditure.

II.A.4.b)(3) Express Warnings

While the EU-legislation does not have any express warnings, some countries use this method, known from the world of cigarette advertising.

In *Belgium* lenders must add to the amount written down by borrowers adjacent to their signature, in a separate line and in bold type, the following sentence: "Never sign an incomplete contract"¹⁷⁶.

In *Great Britain*, consumers must be warned in wording prescribed by the Secretary of State and contained in information handed out prior to conclusion of the agreement, that they must be sure, before entering into the agreement, that they are able to repay the sums borrowed.¹⁷⁷

¹⁷⁵ The most used software in the more than a thousand debt advice agencies in Germany to draw such plans is the programme CAWIN 6.0 developed and distributed by iff Hamburg.

¹⁷⁶ Art. 14 para. 4 no. 2 of the Act of 12 June 1991 in relation to consumer credit: "Ne signez jamais un contrat non rempli".

¹⁷⁷ Consumer Credit (Quotations) Regulations 1989, Schedule 1, no. 18: "Be sure you can afford the repayments before entering into a credit agreement."

In *Ireland*, housing loans have to contain the following warning:

"WARNING – YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP PAYMENTS ON A MORTGAGE OR ANY OTHER LOAN SECURED ON IT.

THE PAYMENT RATES ON THIS HOUSING LOAN MAY BE ADJUSTED BY THE LENDER FROM TIME TO TIME."

And in Section 128 for Endowment mortgages:

"WARNING – THERE IS NO GUARANTEE THAT THE PROCEEDS OF THE INSURANCE POLICY WILL BE SUFFICIENT TO REPAY THE LOAN IN FULL WHEN IT BECOMES DUE FOR REPAYMENT"

Art.14 of the "Loi MURCEF"¹⁷⁸, passed in *France* on 11 December 2001, modified art.L.311-9 of the Code de la Consommation, and requires that all cards enabling consumers to borrow at a time of their choosing must be defined as "credit cards" (cartes de crédit). This provision is intended to protect consumers from taking out unintended loans from the increasing number of cards offered to the public.

II.A.4.b)(4) Information on the Debtor

A rational decision by the debtor requires a comparison between his own disposable income in the coming years and the instalments which he has to pay. This is of course a primary duty of the debtor himself. But he will often not be able to do such a calculation. The concept of "responsible lending", described above, requires a minimum of such investigation, something already required in investment law.

Under art. 11, bullet point 4 of the Directive on investment services in the securities field¹⁷⁹, a company dealing in securities is obliged to obtain from its clients details of their financial position, their experience in dealing with securities and the intended purpose of the financial service in question. Under art.11, bullet point 5, they are then under an obligation to provide their customers with all relevant information in the appropriate form. This regulation takes into account the prospective borrower's personal knowledge, one of the basic requirements of consumer education. Again, transfer of this procedure to credit provision is entirely possible. It is only when providers are aware of their customers' level of knowledge that a real reduction in the information gap between lender and borrower can be achieved. This cannot be done through standardised information alone; dialogue is a prerequisite.

178 Act no. 2001-1168 of 11 December 2001

179 Directive 93/22/EEC

Precisely those consumers who are socially disadvantaged and have limited education will often also have insufficient confidence to make detailed inquiries of lenders about the loans they are being urged to take out. The lender should therefore, as far as possible, take responsibility for ensuring that borrowers understand the product. Investment services in the securities field are mainly relevant to more educated consumers needing protection against the loss of their investment. Protection against overindebtedness is, however, even more important because of the accompanying level of social discrimination, and it should be founded on at least equivalent protective mechanisms.

II.A.4.c) Information on Default Risks

II.A.4.c)(1) Default Costs

While EU-regulation due to its rational choice approach has until now excluded default costs from disclosure rules, national legislation goes far beyond by limiting the cost in default and making the expected cost burden calculable through legally defined default interest rates which include all other costs.¹⁸⁰

Under current European law, there are no duties for information to be provided in relation to the legal consequences of breaches of agreements. The costs arising from a breach are also not expressly included among the costs not incorporated into the calculation of the effective interest rate under art. 4, para. 2 d) of the Consumer Credit Directive.¹⁸¹

Art. 10, para. 2 e) of the new draft of the Consumer Credit Directive requires that consumers be informed of the costs involved in unauthorised overdrafts and of costs arising on breach of agreements. This is especially important because, if consumers frequently fail to read through the information provided on signature of the agreement, they will nevertheless seek advice in a crisis situation, at which time they will also look at the contract. Breaches of agreements arise precisely on the threshold of overindebtedness. Consumers should therefore be informed of their rights and their options at this stage in particular. Unfortunately, the European Directives also neglect the question of information provision in the event of breaches of contract.

Art. 14, para. 3 no. 11 of the *Belgian* Consumer Credit Act¹⁸² requires that the default interest rate must be stated. Stating the rate of interest on arrears makes clear to the consumers that their

¹⁸⁰ See above II.A.2.b) on p 84

¹⁸¹ Directive 87/102/EEC, modified by Directive 90/88/EEC

¹⁸² Act of 12 June 1991 relating to consumer credit

debt will continue to mount up if they fail to make payments on time.

A survey on the cost of early termination on 100,000 euros at a fixed rate for 10 years after 5 years has revealed that - expressed in euros - the differences are between as high as 9,000 in *Germany*, about 1,200 in *Scandinavian* states and a legal maximum of 3,000 in *France*. Home owners in *Germany* should already know, when the contract whose risks are involved in early termination so that they can keep the margin of liquidity higher than they would do if early termination would make no difference to their overall cost burden.

The true cost burden would be calculable only if it was disclosed properly in a form making it compatible with the liquidity tables of the household. It should therefore give examples which would include the complicated system of default rates, compounding rules and rules on anatocism.

II.A.4.c)(2) Delay for Rescheduling Efforts

Lenders in *Germany* must offer borrowers the opportunity of a discussion (art. 498 para.1, sub-para.2 BGB). This enables borrowers to explain their circumstances and breaks down their natural tendency to shy away from discussions with lenders. The contents of these discussions are, however, as unregulated as are the penalties for failing to offer them at all. Offering a discussion does not operate to validate a notice of termination for default.¹⁸³ In practice, this usually amounts to no more than a written comment within the notice setting the time limit for payment, and it is only followed through on very rare occasions. However, the underlying motive of bringing the parties together before termination of the agreement because of arrears, with a view to investigating potential ways of resolving the situation, is interesting. This is further supported by the fact that information is made available to consumers at the very time when they most need it.¹⁸⁴ But 14 days is not long enough, nor does it help to have just a duty without sanctions for breach.

II.A.4.d) Sanctions

All legal rights to prevent overindebtedness either through improved information, warnings or through social rights can be effective only if the creditors observe them properly. As this is not always in their own interest, all these rules have to be sanctioned

183 *Palandt-Putzo*: Gesetz zur Modernisierung des Schuldrechts; Ergänzungsband zu Palandt, BGB, 61. Auflage, Beck: München 2002, art. 498, margin note 8

184 *Whitford, W.C.*: cf. footnote 60, p 264

properly including a person or institution that supervises the application of these rules.

Traditionally, this was the task of the state through administration or, in the United States in particular, the attorney general's office.

In the EU Member States, banking authority, trade supervision, office of fair trading, consumer councils, ombudsman and central banks are supposed to fulfil this task.

But increasingly there are doubts as to whether these institutions will be able to cope with a more complex and remote practice in a market which is partly beyond their reach. Fewer staff for such administration, and the large amount of potential infractions in particular, limit its effectiveness. This development cannot be made up by higher fines or criminal offences.

This is why the consumer himself is required to act as supervisor and attorney general in his own interest.

Self-executing rights are required which combine the individual interest of consumers with the general interest of the implementation of preventive rules.

The right to withdrawal is such a self-executing rule. For usury law there is the right to reduce the individual debt. This also applies to information where consumers have the right to a refund in interest if the APR indicated is missing or too low. Rights to refund also exist in early termination and where default costs are irregular.

But all these rights are less effective with overindebted consumers than with ordinary consumers. Because overindebted consumers are not able to pay back the required amount of credit it makes no major difference to them whether the amount due contains illegal amounts of interest and cost because they need a reduction of their debts or a discharge anyhow. The existing bankruptcy schemes mostly do not provide for a procedure, where the judge has to study the merits of the claims in detail.

Overindebted consumers are therefore in the worst position to act as private attorney generals. If preventive contract law is to be effective, the legislator has to consider enforcement mechanisms which go beyond the individual ability of overindebted consumers. Such means could be class actions which are at present possible in standard contract terms. One could also think about punitive damages in order to make law suits more attractive for attorneys and clients.

A new idea has been implemented in *Germany* where consumer organisations now have the right to sue for consumers' claims in their name.

The rights of the ombudsman in *Scandinavia* or the Office of Fair Trading in the *UK* are also interesting approaches.

II.A.5 Dangerous Credit Products

Major studies carried out in *Germany* during the eighties and the nineties, and currently in the U.S., on defaulting consumer credit¹⁸⁵, mortgage loans¹⁸⁶ and credit card credit¹⁸⁷ provide similar empirical evidence: the form of the credit product has a crucial effect on overindebtedness.

While in instalment credit it was mainly credit distributed through intermediaries, in mortgage loans about two thirds of the analysed files contained combined credit in which credit and savings were linked to each other. The role of credit card credit in debt advice is well known especially in those countries where there is no bank monopoly on loans, so that credit cards are not supervised by bank credit but a form of access to credit in general.

These developments have left their mark in the existing regulations in EU Member States.

II.A.5.a) Broker Credit

Credit intermediaries operate between the lender and the borrower. They appear in two different forms: retailers who arrange credit in order to be able to sell their products and services (broker by occasion), and brokers who arrange detached loans as their primary business. The first group comprising brokers by occasion has generally not been of concern to regulators with regard to specific brokerage activity. They have instead been regulated in terms of the effects of the link between sales contracts and credit contracts.

185 See Reifner, U., et al.: Ratenkredite an Konsumenten (Instalment Credit for Consumers), Verbraucherzentrale Hamburg 1983; for similar evidence in the UK, see Palmer, H./Conaty, P.: cf. footnote 55; see also Domont-Naert, F./Dejemeppe, P.: cf. footnote 54

186 Reifner, U./Keich, R.: Risiko Baufinanzierung, (Risks in Housing Finance), 2nd edition, Luchterhand: Kriftel 1995

187 dti, The US Consumer Credit Market – Trends and Perspectives, 28 March 2002 (Edgar, Dunn & Company) <http://www.dti.gov.uk/ccp/topics1/pdf1/ccusreport.pdf>: summarises its findings as follows: "The last decade, credit card debt has grown to become the main source of revolving unsecured debt in the US. In recent years, pressure on card company profitability has led the cards industry to focus on pricing adjustments as well as innovative marketing practices. Many of these practices have met with opposition from consumer groups who argue that they are not in the interests of the cardholder. Further regulation at national as well as at state level is a likely consequence."

This has been taken up in Directive 87/102/EEC and is now proposed under art. 19 no. 2:

“If the supplier of goods or services has acted as credit intermediary, the creditor and the supplier shall be jointly and severally liable for indemnifying the consumer where the goods or services the purchase of which has been financed by the credit agreement are not supplied, or are supplied only in part, or are not in conformity with the contract for their supply.”

Professional brokers instead have always been seen as a special problematic in relation to overindebtedness. We will therefore deal primarily with professional credit brokers.

Such credit brokers exist particularly in countries where there is a bank monopoly in consumer credit, because in the other countries, individuals can sell the credit they refinance with the banking sector directly to the consumer. Only *Spain* reports that there are no professional credit brokers active in consumer credit.

Credit intermediaries are not covered directly by bank law. They do not lend credit to consumers but intermediate credit contracts for lenders. They have traditionally been seen as part of the wider profession of brokers active in housing, commercial papers and insurance, although credit brokers have always been specialised.

The *German* Federal Supreme Court once defined credit brokers as outsourced departments for credit acquisition for lenders servicing banks primarily and then consumers. This led the court to include broker fees in usury law as a cost of credit and not, as it has always been claimed, as the price for an extra service to the consumer.

Consequently, according already to Directive 87/102/EEC, broker fees and all other cost elements from credit intermediation have to be included in the APR this being implemented in all Member States. They also have to be disclosed as credit costs in the contract.

Two problems concerned the legislator: the adverse incentives of the remuneration and the lack of supervision.

European legislators have traditionally used different methods to control credit brokers:

- supervision and admission
- regulating the broker's fees
- holding lenders responsible for their brokers by
- incorporating broker fees into the usury ceilings

- lender liability for their behaviour.

II.A.5.a)(1) Supervision

Art. 28 of the new Proposal requires registration and supervision of credit brokers in all Member States. There is also the requirement to have a complaints board for credit issues, but this does not expressly address problems arising from brokerage.

Art. 29 requires that brokers disclose their brokerage power and the lender they represent. Fees have to be agreed in writing and they are due only after successful intermediation and only if they do not get additional remuneration from the lender. Brokers also have to disclose to their creditors the amount of offers they have received for this request from a specific debtor over the last two months.

It seems questionable whether the rule forbidding fees from both sides helps to clean up the market. Fees from lenders are preferable because they reintegrate credit acquisition into normal lending activity and stimulate mutual supervision. They should always be allowed but certainly disclosed, while restrictions on the fees that the consumer has to pay will generally reduce the danger of improvident credit extension.

All Member States have one or the other form of licensing and supervision of credit brokers. But this does normally not extend beyond the general supervision of commercial agents or brokers. Only *Austria, Germany, Belgium, France, Italy* and the *Netherlands* have devoted specific legislative effort to professional credit brokers.

The *Irish* report provides the best indication of the two elements of such supervision: licence and recognition by creditors.

Credit and mortgage intermediaries have to have an authorisation which is currently decided by the Office of the Director of Consumer Affairs. They must display their authorisation at their business premises.

Credit intermediaries (i.e. car dealers) must have a letter of recognition from each undertaking they act for and they must specify the nature of the finance that is being arranged to the consumer in writing before the agreement is entered into (S.148) including the fact that they are in receipt of some form of consideration from the institution for whom they act.

The *German* supervisory rule also requires the keeping of records on the credit intermediation.

In *Greece* there are some special requirements for credit brokers which align them closely with bankers:



Credit brokers must have the capacity to contract, 12 years school education, no criminal record regarding financial crimes and be independent of the banking's service (no bank employee). The terms of that contract along with the determination of the remuneration of the intermediaries should in addition be declared to the Hellenic Bank Association, where a confidential file of such contracts is kept.

In *Germany*, credit intermediation has often been adjudicated by the Federal Supreme Court. Especially harmful refinancing through brokers has been seen as a "violation of the Federal Legal Advice Act" and has been subject to lender's liability for improvident credit extension.

As to the effectiveness of the supervision through the administration most reports expressed serious doubts as to whether it is effective in practice.

Table 18: Supervision of Credit Brokers

Member State	Is there an effective Supervision of Skills and Practice of Intermediaries?
Austria	The practice of the trade of the personal loan intermediary is a trade, for which a certificate of competency is necessary in accordance with the regulation for the mediation of personal loans and fortune consultation (see enclosed Kreditvermittlerverordnung.pdf).
Belgium	Intermediaries of loans must be registered with SPF Economie. The Inspection Economique has recently conducted a survey of intermediaries which has led to withdrawal of registration for intermediaries who were using illegal methods such as splitting loans.
Denmark	None (But there are also no intermediaries, or very little of them.)
Finland	None (But there are also no intermediaries, or very little of them.)
France	Article 65 to 71 of the Banking Law, n°84-46 of 24 January 1984: The agent must have a mandate from a credit institution and provide proof of a financial guarantee specifically earmarked to repay sums entrusted to him/her.
Germany	The administrative "Makler- und Bauträger Verordnung" (Order on Brokers) requires keeping of records, disclosure of APR and licence. The regulations are not sufficient for effective supervision. The advertising of intermediaries is aggressive and misleading ("credit without SCHUFA-inquiry", "debts are no obstacle"). A working group established by debt counsellors, called "Working group loan sharks", observes the behaviour of credit intermediaries. The working group informs the Federation of German Consumer Organisations (vzbv) about conspicuous behaviour. They can sue intermediaries. The Law on Legal Advice restricts credit brokerage to refinance old debts if this is accompanied with debt advice.
Great Britain	Intermediaries may require a Consumer Credit Licence in order to operate but otherwise are governed by the contract between them and either the debtor or the creditor using their service
Greece	Article 12 of Joint Decision F1 983-1991 requires intermediaries to be registered at the Chambers of Commerce and Industry of each region, to which they notify this activity. The Chamber of Commerce and Industry establishes a list of the intermediaries registered, which is accessible to anyone interested supervised by the Minister of Development. (Fine up to 60,000 euros). Licence has to be shown on demand. There is no effective supervision of the skills and practice of intermediaries. Only in the Banking Code of Conduct, which is not legally binding, it is stated that the intermediaries must meet some standards.
Ireland	Office of the Director of Consumer Affairs, although mortgage intermediaries will be taken over by IFSRA and credit intermediaries may be. ODCA has done a good job with a skeleton staff but there is no doubt that extra resources would help to provide more effective supervision.
Italy	See the preconditions of "Agenti in attività finanziarie" in art. 3 d. lgs. n. 374/1999 (and art. 3 d.m. n. 485/2001); in order to "mediatori creditizi", see art. 4 d.p.r. 287/2000; it is high school, and honourableness under art. 109 T.U. banc. for bank managers. These operators cannot carry on other business (only instrumental). In the case of breach of legal duties, or if preconditions cease, registration will be erased (art. 6 d.m. n. 485/2001 and d.p.r. n. 287/2000).
Luxembourg	No special legislation. The provisions of the Law of 9 August 1993 and company law apply.
Netherlands	No special supervision

	The credit grantor is responsible for the action of the intermediaries he uses
Portugal	None
Spain	No special legislation. Loans are negotiated directly with the financial institutions regarding personal loans, the only intermediary is the seller, who passes the loan petition on to the financier. Bank of Spain concentrates on the application of the old Complaints Procedure (now called the Commission for the Protection for Clients of Financial Services), and can sanction where there is non-compliance.
Sweden	None (But there are also no intermediaries, or very little of them.)

II.A.5.a)(2) Limiting Incentives for too much and too costly Credit

The first problem arises from the way brokers are remunerated. Their fee is mostly expressed as a percentage of the amount of credit they place. This leads to the adverse incentive to place larger amounts of credit than necessary, so that they earn more. As in most cases, the brokerage fee is charged to the borrower on top of the credit and consequently financed as a credit by the lender. The effects on the consumer are visible only later through increased instalments.

This has led to a significant increase in defaults when a credit was generated through brokers. To cope with these defaults, lenders responded in several ways:

First, the broker fees were split into a commission and a mark-up on the contractual interest rate. Interest is paid to the broker only as long as the credit contract is serviced by regular payments so that the broker also loses money if the credit is in default.

Second, some banks pay the commission out of their profit in order to control the size of the price, especially where usury legislation limits the credit price.

Third, lenders have general agreements with brokers which, on the one hand, give them a credit budget which allows them to disregard general lending standards of the lender, but on the other, makes them liable for it with their own personal assets.¹⁸⁸

Such measures have odd effects on brokers who then start to get involved in debt collection with their former clients in order to keep up their payments. This is difficult to control because brokers have detailed information about the debtor and act in the role of refinancing agencies, new credit brokers, representatives of the lender and debt collection agencies.

Only *Belgian* law has adopted this practice and regulated financial incentives so that the lender alone is in charge of the broker in so far as the consumer cannot be charged for the intermediary's fee,

¹⁸⁸ For example a bank had mortgaged the credit budget with the private home of the broker.

and the payment of commission by the lender is spread over the term of the agreement.

A similar element is contained in *German* legislation to prevent disadvantageous refinancing. The broker has no right to remuneration, if the new credit has a higher APR than the refinanced credit (art. 655d Civil Code).

In general, for example in the *Netherlands* and in *Germany*, brokers are treated as representatives of the lender with the effect that their fault and behaviour is directly attributed to the lender who may thus be liable for violation of the contractual duties.

Table 19: Regulation of Credit Brokers

Member State	What are the Regulations on Contracts with Credit Intermediaries?
Austria	Part 4 (Personalkreditvermittler) of the Broker Law in §§ 33 ff. regulates: Minimum contents of the contract; duration of the contract; collection activity of the intermediary; inadmissible remuneration; duties of the mediator to supply information. These regulations are however toothless, since no sanctions are written in the law. In the "regulation against the exploitation of credit-requesters from 1933" remunerations are held to be excessive, if the intermediary gets more than 2% of the loan amount. The remunerations can be reclaimed in § 4 so far as it is excessive in relation to the achievement of the creditor or the intermediary.
Belgium	The special law provides that: - intermediaries of loans must be registered with SPF Economie - the consumer cannot be charged for the intermediary's fee - payment of commission by the lender is spread over the term of the agreement
Denmark	None
Finland	None
France	Article 65 to 71 of the Banking Law n°84-46 of 24 January 1984
Germany	Credit intermediation is regulated under §§ 655a-e BGB (Civil Code). It requires: § 655a: Written form, indication of the provision as a percentage of the amount; disclosure of provision received from lender, disclosure of the contents of the credit contract, separation from credit contract. § 655b: Remuneration only on successful intermediation and after cooling-off period has expired. In case of refinancing no fees if the new contract has a higher APR than the refinanced credit. § 655d: No other remuneration except costs. The administrative Makler- und Bauträger Verordnung (Order on Brokers) requires keeping of records, disclosure of APR and licence.
Great Britain	Intermediaries may require a Consumer Credit Licence in order to operate, but otherwise are governed by the contract between them and either the debtor or the creditor using their service.
Greece	No special legislation. Article 12 of Joint Decision F1 983-1991 requires intermediaries to be registered at the Chambers of Commerce and Industry of each region, to which they notify this activity. The Chamber of Commerce and Industry establishes a list of the intermediaries registered, which is accessible to anyone interested supervised by the Minister of Development. (Fine up to 60,000 euros). Licence has to be shown on demand. General provisions of the Civil Code on intermediaries (art.703-708), as well as the Banking Code of Conduct (articles 91-100) apply.
Ireland	Intermediaries are regulated under the Consumer Credit Act. Credit intermediaries are regulated by S.144-148 of the Act. Mortgage intermediaries are regulated by S.116-121. Insurance and investment intermediaries are regulated under separate legislation. Credit and mortgage intermediaries have to have an authorisation (currently decided by the Office of the Director of Consumer Affairs) and must display their authorisation at their business premises.

	<p>Credit intermediaries (the most common example being car dealers) must have a letter of recognition from each undertaking they act for and they must specify the nature of the finance that is being arranged to the consumer in writing before the agreement is entered into (S.148). They must also disclose the fact that they are in receipt of some form of consideration from the institution for whom they act.</p> <p>Mortgage intermediaries must also have an appointment in writing from each undertaking for whom they act but there does not appear to be any obligation to disclose the fact that they may receive a commission.</p> <p>Both must pay fees in order to obtain their authorisation but there is no regulation of any fees that they may charge themselves. In practice, any fees they would charge would be to the institution for which they act rather than the consumer. On the other hand, mortgage brokers who do charge consumers fees for arranging mortgages are at present unregulated although there is a proposal in the legislation establishing IFSRA (See Item 4) to regulate them.</p>
Italy	<p>There are special laws about "agenti in attività finanziaria", similar to agency, (see art. 1, par. 1 n), 3, d. lgs. 25.9.1999 n. 374, d.m. 13.12.2001, n. 485), which stipulate loans on behalf of subjects regulated to in art. 106 T.U. banc., but no regulations on fees and other terms.</p> <p>Furthermore there are "mediatori creditizi", similar to a brokerage, under l. 7.3.1996, n. 108 (c.d. Anti-usury Act), art. 16, and d.p.r. 28 luglio 2000, n. 287, who counsel in the field of loans and find lenders to people who are looking for money. All operators have to ask for registration in public registers. In order to fees and other terms, rules about "transparency" (which concern first banks) apply (artt. 115 ss. T.U. banc.,).</p>
Luxembourg	No special legislation. The provisions of the Law of 9 August 1993 and company law apply.
Netherlands	The credit grantor is responsible for the action of the intermediaries he uses.
Portugal	No
Spain	No. Loans are negotiated directly with the financial institutions. Perhaps in cases where an estate agency looks for finance on behalf of a buyer, the ultimate lender is also the financial institution. Regarding personal loans, the only intermediary is the seller, who passes the loan petition on to the financier.
Sweden	No

II.A.5.b) Linked Credit

Linked products of credit and capital life insurance or other investment products are largely accessible through doorstep sales and offer relatively low interest rates on the credit side. But for vulnerable consumers they are dangerous products.

The amount saved in the **capital life insurance** contract may be less than promised at the end of the lifetime of both contracts, because returns on capital life insurance are never guaranteed. In *Germany* at present this leads to the effect that many homeowners who calculated that their mortgages would be paid off through their capital life insurance at maturity now face high remaining debts after the expiration of both contracts because of the dramatic decline in returns in the insurance industry after the capital markets collapsed. These consumers have unexpectedly to look for refinancing which may leave them at the mercy of their present creditors.

Another even more dangerous effect is the way capital life insurance contracts are terminated. If the credit contract is terminated

earlier, the consumer has no immediate access to the saved amount of capital, although through the cancellation the total outstanding debt is due at once. If the capital life insurance contract is then cancelled, the consumer has a right only to the "residual value" which is quite arbitrarily defined by the supplier, and from which at least all commissions and other acquisition costs are deducted. This burdens the illiquid consumer who finds out that his payments have not even reduced his debt by the nominal amount. Such products are too risky and dangerous for vulnerable consumers. But the high commissions paid to insurance agents and brokers, and also to banks which sell these products, create an incentive to sell it at least to those consumers who otherwise would not get credit at all. The high commissions make up for the high risk.

In *Germany* in housing finance, too many homeowners who could afford only a normal credit are sold such combined products.

Such combined products are not so widespread yet in Europe, but they form part of normal housing finance in the *UK*, the *Netherlands* and *Germany*. While in *Germany* the rules on the APR calculation expressly exclude any consideration of the linked product, the *Belgium* regulation now gives consumers a right of withdrawal of a period of one month from the linked insurance contract. This could significantly lower the incentives to extend such products, if there were no costs for early withdrawal and if the right of withdrawal could not affect the terms of the credit contract.

In its new Proposal the Commission has proposed a number of regulations to deal with these increasing phenomena. Although these rules apply only to consumer credit and not to mortgage loans, where such linked products are more common, most Member States adopt these rules also to mortgage loans, which will therefore indirectly have an important effect on the reduction of such dangerous products.

Art. 12 no.7 and art. 20 alinea 3 of the Proposal require the calculation of an integrated APR which will show to consumers the true price of the whole product incorporating those losses into the APR who are occurred by deviating the amortisation into an investment product with a lower rate of return than the credit.

For early termination art. 16 rules that no indemnity shall be claimed,

"b) if repayment has been made under an insurance contract intended to provide a conventional credit repayment guarantee."

But the main regulation is in art. 20 of the Proposal where such linked products require an “ancillary agreement attached to the credit contract”.

In alinea 2 of this article, the seller of the investment product as well as the creditor overtake a joint guarantee that the amount due at expiration is sufficient to repay “the total amount of credit drawn down”.

II.A.5.c) Variable Rate Credit (Credit Cards and Overdraft)

A major source of overindebtedness in the United States is variable rate credit mostly from credit cards. Variable rate credit is also typical for overdraft and for variable rate instalment credit.

Insecurity of this credit facility, arbitrary reductions of the credit limit with a consequent “default by definition” make the effects of such credit on household finance unpredictable.

Under art. 6 I, bullet point 1 of the first Consumer Credit Directive, the borrowers must be informed of their overdraft limit. Art. 25 of the new Proposal also requires that the debtor should be informed “that he has overrun the credit amount or is in an unauthorised overdraft situation and shall inform him of the borrowing rate and/or the charges or penalties applicable.”

Art. 24 para. 1 c) of the Proposal requires a fair reason for a reduction of the credit limit when it states that

“the creditor may not suspend the consumer's drawdown rights unless he justifies his decision and is required to inform the consumer without delay;”

Art. 24 alinea 3 limits tacit debts over the agreed limit for more than three months.

Part II, 1.B.3 of the European Voluntary Code of Conduct for Homeloans of 2002 requires “a description of the home loans offered with a brief summary of the differences between products with fixed and variable interest rates, and their consequences for the consumer”.

Most countries have rules regarding the conditions governing the change of the interest rate. They mostly require an objective basis for the rate change with fixed margins between this rate and the contractual rate as well as equal intervals and fixed percentages of deviations from the reference rate to allow for adaptation. It is generally assumed that variable rate credit should not give the creditor the discretion to impose a higher debt burden.

These rules now form part of arts. 14 and 15 e) of the new Proposal for a Consumer Credit Directive¹⁸⁹ which voids only clauses which

“introduce a system involving a variable borrowing rate which does not relate to the net initial borrowing rate proposed when the credit agreement was concluded and which would exclude all forms of rebate, reduction or other advantages”.

These rules do not visualise future risks. Only when they are expressed in terms of a concrete contract, stating possible additional payments in currency units, could they convey the necessary warning. Such transparency through concrete examples of default has long been called for in capital life insurance and private pension schemes. Consumers need to know how much an early termination would cost them.

But the major problem in all forms of variable rate credit is not solved by these rules.

Art. 2 no. 1 e) of Directive 87/102/EEC exempts overdraft and related credit card credit from all duties of information, as required in instalment credit at the time the credit is taken out. Art. 6 states that it is sufficient for this information to be given in general terms at the time the account was opened, which may be years before the first credit is taken out. It requires information at the time, when the general agreement is concluded concerning the credit limit, the annual rate of interest, the charges applicable, the conditions, under which these may be amended, and the procedure for terminating the agreement. These exemptions have been adopted by all Member States.

This means that consumers, who use their credit card or plastic cards which give access to overdraft credit, learn about the debt burden and its consequences only after they already have taken out the credit and spent it. This may be acceptable for smaller amounts of credit. But since overdraft credit is now five times the size of monthly income, and credit card credit seems to increase endlessly, the legislators should consider limits beyond which normal information has to be disclosed, as is the case for all other forms of consumer credit. It would help to slow down the shift

189 “1. The borrowing rate may be fixed or variable. 2. Where one or a number of fixed borrowing rates have been established, they shall apply for the duration of the period specified in the credit agreement. 3. A variable borrowing rate may not vary until the end of agreed periods provided for in the credit agreement and may do so only in line with the agreed index or reference rate. 4. The consumer shall be informed of any change to the borrowing rate, on paper or on another durable medium. This information must include the new an-

from predictable and regulated instalment loans towards uncontrolled and spontaneous credit card debts in the advanced credit societies.

II.B Other Debts

II.B.1 Utility Companies

The privatisation of public utilities – energy, water and telecommunications suppliers – and the introduction of competition in this market segment have caused new problems for low income and other vulnerable households within the last decade. In particular cases, these problems range from

- dubious selling practices (e.g. doorstep and telephone sales, improper sales techniques),
- poor service after transfer from one supplier (e.g. public supplier) to another supplier (e.g. private utility company),
- billing errors and insufficient information about client's accounts, and
- oppressive debt collecting practices.

"Fuel poverty" plays a major role nowadays, especially in *Great Britain* and *Ireland*. The British Government defines fuel poverty as a situation when a British private household has to spend 10% or more of its monthly income on energy to maintain an adequate standard of warmth.¹⁹⁰ An estimated 4.5 million UK citizens fall into this category.¹⁹¹ The empirical study „The Fuel Picture – CAB¹⁹² clients' experience of dealing with fuel suppliers"¹⁹³, produced as part of a cooperation project between the National Association of Citizens Advice Bureaux and British Gas, enumerates the multiple problems CAB clients face with private utility suppliers:

- poor sales practices,
- vague supplier identity,
- unexpectedly higher bills after supplier transfer,
- difficulties in canceling an unwanted transfer,
- billing errors,

nual percentage rate of charge, the creditor's new total lending rate and, where applicable, the new amortisation table."

190 UK Department for Environment, Food and Rural Affairs / UK Department of Trade and Industry, The UK Fuel Poverty Strategy, November 2001

191 *Monroe, F./Marks, S.*: The Fuel Picture – CAB clients' experience of dealing with fuel suppliers, National Association of Citizens Advice Bureaux (NACAB), June 2002

192 Citizens Advice Bureau

193 *Monroe, F./Marks, S.*: cf. footnote 191

- problems with prepayment meters,
- oppressive and abusive practices of debt collecting agencies, and
- cost-intensive telephone services¹⁹⁴.

Great Britain – and also *Ireland* – does not yet have specific regulations to protect consumers against cutting-off policies by (private) utility suppliers (including water and telecommunication suppliers).¹⁹⁵ Therefore, conflicts with suppliers form an integral part of the everyday business of debt or money advice agencies in these countries. They are dedicated to observing the business practice of private suppliers and preventing cutting-off-practices. The British Government has now set a target of minimizing the problems with fuel poverty for vulnerable households by 2010.¹⁹⁶

Apart from Great Britain and Ireland, only *Austria*, *Greece*, and *Luxembourg* do not provide special regulations to protect low income and other vulnerable private households from getting into arrears with their payments and so having services cut off. In the last-named countries, either utility companies (especially former public ones) are tolerant towards households with arrears, or debt and money advice agencies intervene in particular cases in order to settle the disputes between their clients and (private) utility companies.¹⁹⁷ The major *Greek* telecommunications companies maintain their service as long as the outstanding payments of a debtor do not exceed 1,000 euros.

The remaining Member States have different ways of preventing or limiting cutting-off policies against low income or overindebted consumers:¹⁹⁸

Table 20: Prevention of Cutting-off Practices in Case of Arrears

Member State	Regulation / Measure
Belgium	Debtors' request to maintain a minimum level of electricity supply.
Denmark	The general terms and conditions of private utility suppliers are under the supervision of the Danish Energy Authority. The incorporation of a new term concerning special notice requirements is one result of the Energy Authority's intervention.
Finland	In case of social force majeure (e.g. unemployment) electricity can not be cut off before two months have expired. In case of a permanent residence electricity can not be cut off during the winter until 4 months after the bill became due.
France	On request of the debtor the responsible Departmental Solidarity Commission (or another social body) decides whether a cutting-off is just and reasonable.

194 estimated 6 % of the monthly telephone bill (l.c., p.4)

195 Item 35 of the questionnaire (cf. Final Report, Part II: Annexes, II.B)

196 *Monroe, F./Marks, S.*; cf. footnote 191

197 Item 35 of the questionnaire (cf. Final Report, Part II: Annexes, II.B)

198 The answers of the various national experts concern in particular energy utility companies.

Germany	Public suppliers: a contract is not cancelled if the cutting-off would be disproportional (§ 33 ABVEltV – General terms and conditions of public utility suppliers). The general terms and conditions of private suppliers do not include a similar exception clause.
Italy	Public suppliers have to maintain their service if the debtor's default is not severe or if the cutting-off would be a breach of good faith. Public authorities (e.g. Autorità Energia, AGCOM) control the practices of utility companies.
Netherlands	Suppliers may grant a respite and debtors are entitled to reach a payment settlement (Algemene Voorwaarden voor de Levering van Elektriciteit 2002 voor Huishoudelijke Verbruikers, Article 4).
Portugal	Law n.23/96 of 26 July 1996 establishes mechanisms to protect utility services users (energy, gas, water, and telecommunication supply): (1) cutting off the supply is prohibited without notifying the user at least 8 days in advance; (2) the supplier has to look for alternative solutions in order to avoid the cutting-off.
Spain	Cutting off the supply is prohibited without prior notification.
Sweden	The municipalities are obliged to assist debtors to solve conflicts with utility companies.

The afore-mentioned protection measures can be summarised as follows:

- state control of utility companies' business conduct (*Denmark, Italy*)
- protection of a minimum standard of living (*Belgium, Finland, France, Germany, Italy, Sweden*)
- prolongment of payment or other forms of arrears repayment (*France, the Netherlands, Portugal, Sweden*)
- prior notification (*Portugal, Spain*)

The degree of protection against cutting-off practices within Member States differs. Even if all Member States are conscious of the special problems with these practices, the protection remains insufficient where problems are solved on a voluntary basis – observation of suppliers' practices, debtors' advice in cases of conflict – and not on a mandatory basis (*Austria, Great Britain, Greece, Ireland, Luxembourg*). In that case, the debtors are not entitled to enforce their claim that the supplier has to maintain its service. The nature of the protection is haphazard. In those Member States, where the regulations (including general terms and conditions) require a prior notification but have no exception clause for social force majeure the protection is fragmentary, too.

II.B.2 Rent Arrears

Nearly all Member States, except *Portugal*, offer subsidies and/or statutory protective regulations in order to avoid eviction (for more details see Table 11: Tenants' Protection against Eviction ("Acceleration of Fixed Capital") giving a review of the national measures).¹⁹⁹ However, these safeguards are not primarily targeted at the prevention of overindebtedness but at the continua-

199 For more details see Final Report, Part II: Annexes, Answers to Item 36 of the questionnaire.

tion of the tenancy agreement and thereby the prevention of homelessness.

National protective measures can be outlined as follows:

- The least protective measure is the requirement that the landlord has **only to file an action for possession** (*Austria, Finland, Great Britain, Ireland*).
- *Belgium, France, Germany and Sweden* **combine** this formal requirement with additional pre-conditions (see the following listing).
- **Solely extra-judicial proceedings** in the form of **conciliation** apply in *Luxembourg*.
- Besides the requirement of a court proceeding, **further formal pre-conditions** are either the landlord's **prior notification** to the appropriate **social welfare organisation** (*Belgium, Sweden*) or the landlord's **written advance notice to the tenant** (*Austria, Denmark, Finland, Germany, Ireland, Sweden*).
- *Belgium and France* (up to two years) grant a **prolongment of the term of payment** available at the tenant's request.
- The **time period** before the tenant has to relinquish occupation is one month in *Belgium*.
- A **stay of execution** may be granted at the tenant's request (*France*: up to three years, *Germany*: one year plus, *Italy, Luxembourg*: maximum of nine months) or automatically (*Italy*).

France seems to provide the most comprehensive protection against eviction, although this evaluation requires updated data on the number of repossession actions and their findings. *Portugal*, with no protective measures, faces the biggest backlog of demands to protect tenant agreements. A combination of (1) an advance notice, (2) a conciliation procedure, (3) a prolongment of payment terms, and (4) a temporary stay of execution would best meet the interests of both the landlords and the tenants.

II.B.3 Alimonies

Alimony payments to children and, less frequently, to former spouses are an important source of overindebtedness for one group of debtors. Because alimony often amounts to a considerable portion of the person's income, payments easily generate a heavy debt burden in a fairly short time. For example, temporary unemployment may lead to considerable indebtedness. Sometimes there is also a notable reluctance towards making alimony payments. Alimony payments may be part of a larger debt prob-

lem, but some debtors default only on alimony payments, accumulating a considerable debt burden but have no other debts at all.

Since alimony payments are adjusted to the debtor's income, a permanent decrease in income entitles the debtor to ask for reduction in alimony. This is in practice the most important preventive measure against overindebtedness as a consequence of alimony payments. In practice, however, it does not prevent all debt problems deriving from alimony debt. Sometimes temporary unemployment does not entitle to reduction, but inability to pay for some months can accumulate a debt burden which is hard to pay off while at the same time maintaining concurrent payments. In many cases, the debtor is unable to start negotiations for reduction in monthly payments before the debt burden is incurred.

The children's position is usually secured by a state guarantee for minimum alimony. As a consequence, the main creditor for alimonies is usually the state, represented by the social services or other like bodies. In the enforcement of alimony claims it may thus be appropriate to make a distinction between the child and the public as the creditor.

On the whole, alimony debtors are a special group of debtors. When alimony debts are part of a larger debt problem, they must be included in the consumer insolvency scheme. When they are the main source of the debt problem, it may be more appropriate to design special measures to tackle the problem.

II.B.4 Tax, Fees, Fines

Claims for payments to the state, relating to special public or administrative law, such as taxes, public fees and criminal and administrative fines and other sanctions, are subject to specific regulations in most countries. Very often these regulations also include provisions for cases in which the debtor is unable to pay because of lack of money.

As will be explained in subchapter II.D.4.c) consumer insolvency laws also usually give discharge from these kinds of public law debts, with the exception of fines. In this subchapter reference is made only to regulations that specifically concern collection of and relief from public payments.

We have not been informed of any specific regulations in this respect in *Austria, Belgium, Greece, Italy, Luxembourg, Sweden* and the *UK*.

In *Denmark*, the general rules in the Bankruptcy Act on Debt Adjustment also apply to taxes etc. Similar rules are found in the tax legislation (Act no. 169/2000 on Collection of Taxes etc. (*Lov om*



opkrævning af skatter og afgifter) § 15) making it possible to grant debtors with only tax debts etc. relief without initiating the rather complicated debt adjustment procedure in accordance with the Bankruptcy Act.

In *Germany*, various regulations in Federal and Land Law provide facilities of payment. If the payment would constitute an unreasonable hardship, the debtor may claim for

- settlement,
- prolongment of payment,
- abatement of a fee,
- release (wholly or partly) or
- payment by instalments.

Examples:

- Tax arrears: release (wholly or partly) under § 227 AO (*Abgabenordnung/Tax Code*).
- Fines: law enforcement authorities may decide on facilities of payment after the final judgement (§ 459a StPO - *Strafprozessordnung/Code of Criminal Procedure*).
- Fee arrears: Federal and Land Budgetary Regulations provide different facilities for payment.

In *Finland*, distress for non payment of taxes may continue for only 5 years. A debtor may seek relief from the tax authorities in case of social force majeure.

In *France*, the general rule is that tax offices retain the power to grant time or remission of debts. However, in the context of over-indebtedness, where the commission proposes that the debts be purged because of the debtor's insolvency, the request for tax debts to be written off is a matter for the tax office. For semi-fiscal debts (TV licence fee), fines and social security debts, the commission has no power to impose repayment of the debt by instalments. At the moratorium stage, it may propose that the debt be suspended.²⁰⁰ Recently it has been proposed that tax debt should also be included in consumer insolvency procedure.

In *Ireland*, there are refuse collection charges (levied by local authorities). Means tested exemptions on low-income grounds are applied by various local authorities in respect of these:

200 See art. L331-7-1 and the tax directive of 5 February 1999

- Local authority rents - hardship clause: The Guidelines for Local Authorities on Rent Assessment, Collection, Accounting and Arrears Control (drawn up by the Housing Unit operating under the auspices of the Department of Environment) provide that "local authorities should ensure that their differential rent scheme includes a hardship clause which makes provision for the acceptance of a lower rent than that required under the terms of the scheme, in exceptional cases where payment of the normal rent would give rise to hardship".
- TV licenses: By voluntary agreement between the Post office and Money Advice and Budgeting Services (MABS), a local post office will grant a 3-6 months moratorium following contact by MABS for more time to purchase the license.

Petitions may be made to the Minister for Justice to reduce/set aside fines.

Extra time to pay may be granted in line with specified procedures available to the public under the Freedom of Information Act.²⁰¹

In *Portugal*, a reduction of tax evasion fines is sometimes possible. The state may grant an occasional discharge from interest on unpaid taxes, as well as reducing or waiving related fines.

In the *Netherlands*, there is a discharge from tax debts (Leidraad invordering 1990, Algemene wet inzake rijksbelastingen) and public fees for the poorest people (locally arranged per city).

In *Spain*, the General Taxation Act is the keystone for the Spanish tax system. This norm allows for the extension, reduction or deferment of payment, but with interest added for any delay in payment: granting an extension or deferment is at the discretion of the Department of Tax, taking into consideration the economic-financial situation of the debtor. The general rule is that guarantees are required, in the form of joint guarantees from the bank or from similar financial institutions.

In conclusion, the need for relief from public payment liabilities, especially taxes is recognized in many Member States and special relief procedures have been set up. It has to be noted, however, that tax authorities are often cited as the most reluctant creditors to participate in voluntarily negotiated settlements, so there is some doubt as to whether the relief procedures are debtor friendly in practice.

201 See the respective government websites: <http://www.welfare.ie> and <http://www.revenue.ie>

II.C Debt Collection and its Limits

II.C.1 Out-of-Court Procedures

Greece has no regulations on assignment of wages and in *Denmark* and *Finland* assignment of wages is not allowed. In *Ireland*, it is only allowed in family law cases, but not in respect of civil debts or fines.

In *Sweden*, it is not permitted to assign salary or wages before they are due. In other words, the wage earner may not dispose of his wages before the date they are due. Similarly, the wages that are not yet due cannot be subject to assignment.

In *Austria*, assignment of wages for demands not yet due in consumer contracts are forbidden under the Consumer Protection Law:

§ 12, para.1 Kündigungsschutzgesetz: Wages or salaries of consumers may not be assigned to entrepreneurs for security or for satisfaction of demands not yet due.

In practice, this prohibition is circumvented. Instead of assignment of wages (in which the bank steps into the salary claim right of the debtor against his employer) the banks obtain contract attachments of the wages from the debtors (here the bank does not own the claim for wage, but the wage claim is contractually attached to the creditor as security of the credit). Employers are allowed to make payments due to a contractual attachment right only if the creditor has a requirement on utilization and this was indicated to the employer (§ 300a EO).

In *Belgium*, assignment of earnings is a documented process in which the consumer empowers the creditor to obtain payments directly from his employer, without requiring an order from the judge (unlike in the case of attachment of earnings or delegation). Most lenders require that borrowers sign an assignment of earnings by way of a guarantee of their liabilities. The Law of 12 April 1965 on the protection of workers' income provides that, for the assignment to be valid, certain formalities must be observed:

- a separate document: an agreement to assign income to a creditor must form a distinct part of the agreement whose fulfilment it guarantees;
- both consumer and lender as well as, if applicable, the guarantor, must be given a copy of the assignment document;
- if the purpose of the assignment is to guarantee repayment of a consumer loan, the document must cite the articles of the Law describing the procedure enabling the consumer to object.

Because the creditor has possession of an assignment, he can apply directly to the employer in the event of default by the consumer. However, the creditor must observe certain formalities:

- the creditor must first notify the consumer, by registered letter or through the huissier (enforcement authority/enforcement agent) of his intention to give effect to the assignment;
- the creditor then sends a copy of this notice to the employer;
- within the 24 hours following dispatch of the copy, the creditor must send a notice to the Greffe (clerk) of the consumer's local court. All notices of attachment or assignment relating to the same person are held there centrally;
- the creditor must then wait for 10 days (to enable an objection to be made) and send the employer a certified copy conforming to the assignment document.

Only at that point is the employer obliged to pay all or part of the worker's income direct to the creditor.

The law enables the worker to oppose implementation of the assignment document. As soon as the creditor has advised him of his intention to give effect to the assignment, the worker may send his employer a letter by recorded delivery stating that he opposes the assignment. The employer must then, within 5 days following receipt of the letter, inform the creditor that implementation is opposed. At that point, the employer is no longer bound by the assignment and will continue to pay the worker all of his wages.

The law provides for implementation to be opposed for a period of 10 days, but it is still possible to oppose it subsequently. If that is the position, opposition is only effective in relation to subsequent assigned payments. If the employer has already paid certain sums to the creditor, those sums do not have to be repaid.

It is not necessary to give reasons, but if the creditor pursues the procedure, the borrower will have to justify opposition to implementation to the Juge de Paix. In practice, the consumer opposes implementation, either because the validity of the assignment is disputed (no signature or absence of obligatory formalities or if the consumer contests the debt), or because the consumer hopes to obtain the resources to repay the debt.

In order to enable each individual to live with human dignity, the law provides for certain income to be partially or completely unavailable. The rules below also apply to attachment of earnings.

Arts. 1409 and 1410 of the Code Judiciaire list the income protected by the exemption rules. Basically, the income relates to holiday pay and substitute income (pension, unemployment benefit, disability benefit) and maintenance. Family allowances, disability allowances, minimum income, guaranteed income for retired people, social security paid by the C.P.A.S. are all completely exempt.

With regard to other income, the amounts that can be paid over are modified each year and vary according to income. For 2003:

- up to € 857: 0%
- from € 857.01 to 921: 20%
- from € 921.01 to 1,016: 30%
- from € 1,016.01 to 1,111: 40%
- over € 1,111: 100%

The law provides that, where an assignment is implemented, the employer must pay the remaining element over, at the option of the worker, either directly, or by postal transfer, or by cheque.

In *Germany*, assignment of wages is not regulated by any special provision. The jurisdiction derives assignment of wages from art. 398 BGB (Civil Code) which originally regulated the assignment of claims. Unlike other special provisions regulating credit collaterals art. 398 BGB does not determine rights and obligations and especially not protected privileges.

Consumer credit contracts provide a standardised assignment of wages clause. In 1989, the Federal Court of Justice determined the requirements of an effective standardised assignment of wages clause:

- objective and amount of the assignment must be clearly specified,
- the clause must include a release declaration,
- clear regulation as to the terms and conditions for realizing the security.

The debtor may avoid his assignment due to his credit contract being contrary to good morals (art. 138 BGB). The assignment clause in a credit contract is not effective, if the individual labour contract or a collective agreement (e.g. Volkswagen AG) excludes or prohibits wage assignments.

In *Italy*, one fifth of an individual's wages can be assigned (see d.p.r. 5.1.1950 n. 180).

In the *UK*, any deduction from wages by an employer is subject to an express prior written agreement of the employee, or alternatively by court order pursuant to an attachment of earnings order for the enforcement of a judgment debt.

Deduction from wages, pursuant to the Employment Rights Act 1996, must be in writing, signed by the employee before the relevant deduction is made. There is a restriction on the amount of deduction that can be made by an employer for matters such as stock shortages in retail employment. An order for the attachment of earnings is subject to the courts' discretion on the creditors' application to enforce a judgement debt.

II.C.2 Debt Collection Agencies: Role, Power, Legal Situation and Costs

In *Denmark* and *Greece* there are no regulations on debt collection. Also in *Portugal*, there are no regulations for debt collection by private entities, although debt collection companies operate on the Portuguese market.

Ireland does not regulate private debt collection. However, harassment of debtors is covered by Non-Fatal Offences against the Person Act 1997. The relevant provisions with regard to creditors or debt collection agents putting undue pressure on a client are contained in sec. 11, and are reproduced in full below:

(1) A person who makes any demand for payment of a debt shall be guilty of an offence if

- (a) the demands by reason of their frequency are calculated to subject the debtor or a member of the family of the debtor to alarm, distress or humiliation, or
- (b) the person falsely represents that criminal proceedings lie for non-payment of the debt, or
- (c) the person falsely represents that he or she is authorised in some official capacity to enforce payment, or
- (d) the person utters a document falsely represented to have an official character.

(2) A person guilty of an offence under this section shall be liable on summary conviction to a fine.

Enforcement of these provisions is the responsibility of the Garda Siochana; the client can make a formal complaint to the Gardai.

In *Belgium*, recovery of loans is regulated by the Law of 20 December 2002 relating to recovery by consent of consumer debts. Practices likely to mislead the consumer, and/or affect his private life or his human dignity are prohibited both by the head of the

debt recovery office and the head of the creditor company. The Law targets in particular:

- incorrect information as to the consequences of default in making a payment;
- use of a statement on the envelope to show that the letter relates to a default in making a payment;
- application of charges not provided for in the loan agreement;
- approaches to the debtor's neighbours, family or employer;
- recovery of sums due from someone other than the debtor;
- recovery of sums due in the presence of a third party (except with the consent of the debtor);
- express and deliberate harassment of a debtor who disputes the debt;
- procedures designed to obtain acknowledgement of the debts, a bill of exchange or an assignment of wages from the debtor;
- telephone calls and home visits between 10pm and 8am.

Debt recovery agencies must be registered with SPF Economie. All attempts to secure recovery of a debt on an amicable basis must be preceded by written notice setting out details of the debt.

Further, in the event of a home visit to the consumer, the debt recovery agent must produce a document stating his name and a warning that the consumer is not compelled to agree to the visit and may bring it to an end at any time. He must also provide a receipt for any payment made in the course of the visit.

The recovery office cannot claim fees which were not provided for in the credit agreement from which the debt arises.

In *Germany*, the debt collection business is subject to the Legal Advice Act (Rechtsberatungsgesetz). Debt-collecting agencies have to be licensed pursuant to art. 1 § 1 para. 1 no. 5 of the Legal Advice Act. The license is granted by the president of the local or regional courts. The license is limited to out-of-court debt recovery.

The collection business has to be registered at the Trade Supervisory Office (art. 14 of the Industrial Code). The Federal Code of Lawyers' Fees (Bundesgebührenordnung für Rechtsanwälte) determines the level of remuneration for lawyers. The upper limit of the lawyers' fees applies to debt-collecting agencies due to art. 254 of the Civil Code (Bürgerliches Gesetzbuch). Art. 254 of the Civil Code regulates contributory negligence. According to that the creditor is obliged to mitigate his loss. If a creditor had instructed



a collecting agency and if he had to prosecute a claim nonetheless, he has to bear the additional costs (collection fees). If the creditor can foresee that he has to consult a lawyer, i.e. because the debtor is visible insolvent, the debtor is not obliged to pay remuneration for the lawyer and the collecting agency. Debtors therefore have to bear collecting fees only if the collection service has been proper and promising.

In *Finland*, private debt collection is regulated by the Act of License for Debt Collection (1999/517). The county administration of South Finland - State Provincial Office - permits debt collection but it has to be practised in a professional manner. According to the Act of Debt Collection (1999/513) the collection costs must be reasonable, having regard to the size of the debt and how much work has been done. The maximum debt cost the courts accept is 60 € for an ordinary written procedure.

Private debt collection is provided by The Act of License for Debt Collection and The Act of Debt Collection. The Act of Debt Collection has some restrictions that can be mentioned here. If the debt (e.g. some insurance) can be collected by execution without a judgment, the cost may not exceed 12 €. Private debt collectors are not able to collect public fees that can be collected by execution without judgment.

In *France*, the debt recovery profession is registered by décret no. 96-1112 of 18 December 1996. Costs of the "huissier" are set out in the décret of 12 December 1996. It should be noted that, in the overindebtedness procedure, the debtor may be exempted from huissier's fees if he informs the huissier in time that he has lodged a file with the overindebtedness commission. There is a maximum for debt collection costs for bailiffs.

The rule in relation to debt recovery is that the creditor is responsible for the fees. On the other hand, if there are legal proceedings for recovery of a debt, the debtor is responsible for the costs but the judge may reduce them or write them off if they were unjustified or excessive.

In *Italy*, there are rules about "agenzie di recupero crediti" (see art. 1, para. 1, a), d. lgs. n. 374/1999). These are operators which collect debt on behalf of creditors (others are factors, who buy credits, under l. n. 52/1991). They have to apply for an administrative licence under art. 115 r.d. 18.6.1931, n. 773 (c.d. T.u.l.p.s., which legislation about public safety, and no real checks are made). There is no specific and complete regulation; "agenzie di recupero crediti" only have to note all "suspect" operations they find (in case these are the outcome or results of illegal business



activity). There is a private association – unirec – that has adopted an ethical code of practice.

There is no maximum for collection costs but fees for debt collecting operators have to be disclosed to the public. Private debt collection is not otherwise restricted but these operators cannot employ force, or otherwise constrain debtors to pay.

In *Luxembourg*, debt recovery companies are not regulated by specific legislation but fall within company law provisions. The Law of 11 November 1970 applies. Fees for recovery are not set by law unless they are fees of the huissier de justice, which are set by the Grand-Ducal regulation of 14 May 2001.

In the *Netherlands*, private debt collection is not specifically regulated by law. Private debt collection is not restricted. It is based upon self-regulation.

In *Sweden*, there is a Debt Collection Act which defines (1) who is allowed to carry out debt collection, (2) the manner in which the claims must be made and (3) which costs may be charged for debt collection. There is a schedule which is adjusted at certain intervals and which states that collection costs may reach certain maximum amounts (currently, SEK 150 for claim, SEK 140 for drawing up an instalment schedule, and SEK 45 for reminder). This derives from Decree (1981:1057) on Reimbursement of Debt Collection Costs.

In the *UK*, private debt collection is governed by codes of practice for members of relevant trade bodies. Private collection is not regulated, but any demand for costs of collection must be in accordance with the contract between the creditor and debtor. The courts retain ultimate discretion on whether to uphold any contractual provision under relevant consumer protection legislation if the matter is brought before them, which is not a requirement.

II.C.3 Legal Debt Recovery

In *Denmark*, wage garnishment is not allowed for commercial claims. Only claims that derive from family law or public law can be enforced by garnishment.

In *Ireland*, legal debt recovery is not applicable in civil debt cases, only in family law cases.

Belgium regulates recovery from individuals as follows: In order to enable each individual to live with human dignity, the law provides for certain income to be partially or completely unavailable. Arts.

1409 and 1410 of the Code Judiciaire list the income protected by the exemption rules.²⁰²

In *Germany*, there are restrictions on attachments of the earnings of debtors. All debtors are entitled to a certain statutory level of income which is exempt from attachment, based on their essential outgoings (see art. 850c Zivilprozessordnung - Code of Civil Procedure). Income exceeding this level may be attached in full. The following matters must be taken into account in the calculation of earnings:

- certain elements of income cannot be attached (e.g. child maintenance, housing benefit),
- certain elements of earnings can be attached only in part (e.g. christmas bonus, overtime pay).

The element of income exempt from attachment may be increased on application of the debtor to the court, in particular to prevent the debtor becoming reliant on social security payments or to take into account special personal or work-related needs on the part of the debtor (art. 850f Code of Civil Procedure). Once the exemption levels have been raised in favour of the debtor with effect from 1.1.2002 it may be assumed that the number of applications brought under art. 850f ZPO will be significantly reduced or courts will grant such applications less frequently.

In *Greece*, art. 982 para. 2 of the Code of Procedure in Civil Cases prohibits garnishment of wages. The following is the only exception to this rule: Wage garnishment for maintenance claims provided in the law or in a will or for contribution to the income of the family. In that case, garnishment is allowed only up to half of the wage, after the following elements are taken into account: the income of the person concerned, the financial obligations created by the marriage and the number of the persons entitled to maintenance.

In *France*, the attachment of earnings procedure begins with a conciliation hearing before a judge in a court of first instance. The judge may grant time for payment and check the validity of the claim. Where the claim is disputed, he examines the details of the dispute provided by one of the parties. If the judge does not grant time for payment and if the debt cannot be repaid, attachment occurs during the following week. The employer is notified of the order and the notice includes the percentage of the salary to be attached. The employer must send that amount every month to the court clerk's office (greffe du tribunal). Only a fraction of the

202 For details see already subchapter II.C.1

salary can be attached. It is set by order and the scale applied takes into account the number of dependant children.

Finland has two important restrictions on wage garnishment based on The Act of Execution and The Decree on Protected Share of Wages. The necessary living expenses of the debtor must be protected and the maximum that can be seized is 1/3 of the net income. In addition, there is an absolute minimum income which is protected.

In *Italy*, one fifth of the wages can be garnished, see d.p.r. 180/1950.

In *Portugal*, art. 824/1, item a) of Code of Civil Procedure provides that 1/3 of the debtor's wages can be assigned.

Art. 824/1, item a) of the Code of Civil Procedure provides that 1/3 of one's wages can be assigned. As provided for in art. 824/3 of the Code of Civil Procedure, the judge can exempt debtors from assignment of wages (as well as 1/3 of old-age pension or disability allowance, or other social benefits, insurance or indemnity against accidents), taking into account the nature of the debt and the needs of the debtor and his family.

In *Luxembourg*, only earnings from work can be attached or assigned; the guaranteed minimum income, family allowances, parental leave allowance, maternity pay and educational grants cannot be attached.

The issue of attachment of earnings is dealt with in the Civil Procedure Code and through various specialist enactments (Law of 11 November 1970 amended to provide for assignment and attachment of earnings from work as well as pensions and benefits and the Grand-Ducal Regulation of 8 January 1973, setting a rate for the provision to assign and to attach earnings, pensions and benefits). The attachment and seizure procedure is governed by the provisions of the Law of 11 November 1970 and the Grand-Ducal Regulation of 26 June 2002.

The payroll of civil servants and the salaries of employees are targeted by these provisions or, more precisely, people working for one or more employers in whatever capacity, those in receipt of unemployment benefit, pensions and social security benefits, whatever the amount and the nature of the income are targeted by the provisions above. The principal and ancillary sums related to this income are targeted, with the exception of sums allotted by way of repayment of set fees.

Draft legislation dated 16 May 2002, no. 4955, amending the amended Law of 11 November 1970 on assignments and attach-

ments of earnings, pensions and benefits, was lodged in the Chambre des Députés.

The Grand-Ducal Regulation of 26 June 2002 sets the levels of income from earnings, pensions and benefits that can be assigned or transferred as follows:

- The first tranche: up to € 550 a month
- The second tranche: € 550 to € 850 a month
- The third tranche: € 850 to € 1,050 a month
- The fourth tranche: € 1,050 to € 1,750 a month
- The fifth tranche: above € 1,750 a month.

In the *Netherlands*, up to 90% of the minimum wages of an employee's income is exempted, but above this percentage attachment is unrestricted (art. 475c, art. 475d RV).

In *Spain*, the salary can be garnished, but there has to be access to the minimum to meet basic needs. The Law of Civil Procedure allows the seizure of wages, but first certain other items are seized, such as cash or any type of current account; in seventh place household goods; in eighth place salaries or wages; and ninth credits or other mid to long term rights (art. 593).

Art. 607 states that any salary, wage, pension, compensation or its equivalent, cannot be seized if it is below the interprofessional minimum wage (15.04 euros/day or 421.20 euros/month²⁰³).

Anything above this minimum can be seized according to the following scale:

- For the first additional amount up to the double of the minimum interprofessional wage, 30%.
- For the additional amount up to three times the minimum interprofessional salary, 50%.
- For the additional amount up to four times the minimum interprofessional salary, 60%.
- For the additional amount up to five times the minimum interprofessional salary, 75%.
- Any amount exceeding the previous one, 90%.

If the individual has more than one source of income, the amount seized is subtracted on a one-off basis, from the accumulated total of all the sources. With married couples, when the arrangement is

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not one of division of property and all types of incomes, the tribunal considers the accumulation of all salaries, wages and pensions, compensations and equivalents.

Upon consideration of family responsibilities of the debtor, the tribunal can apply a reduction of between 10 and 15% of the totals.

In *Sweden*, there are specific provisions in the Debt Enforcement Act. This is a very common – and effective – form of enforcement. Garnishment of wages is permitted for any type of debt and may go on indefinitely. The debtor may keep a certain amount to satisfy basic needs. The rest is handed over to the creditor who has sought garnishment. In order to effect garnishment, the creditor must have an enforcement order from the court. The state need not have a court order but can carry out garnishment directly.

II.D Consumer Insolvency Regulation

II.D.1 European Consumer Insolvency Laws

Today ten out of 15 Member States have a consumer insolvency regulation.

Table 21: Consumer Insolvency Regulations in the EU Member States

Member State	Status	Year	Law
Austria	Yes	1994	Konkursgesetz
Belgium	Yes	1999	Loi sur le règlement collectif des dettes
Denmark	Yes	1984	Konkurslov
Finland	Yes	1993	Debt Adjustment Act
France	Yes	1990	La loi sur le surendettement
Germany	Yes	1994 (in effective 1999)	Insolvenzordnung
Great Britain	Yes	1881	Administration Order
Greece	No		
Ireland	No		
Italy	No		Drafting in process
Luxembourg	Yes	2000	Loi la prévention du surendettement; Civil Procedure Code
Netherlands	Yes	1998	Consumer Bankruptcy Act
Portugal	Draft		
Spain	No		
Sweden	Yes	1994	Skuldssaneringslag

The state of law in the Member States is as follows:

Greece and *Spain* do not have specific consumer bankruptcy legislation and as far as it was reported no draft proposals for such a law have been presented. Some discussions about the need for such legislation have been going on but political pressure has not yet called for action.

In *Ireland*, there is bankruptcy legislation (Bankruptcy Act of 1998) but this is totally inappropriate to, and hardly ever used by, debtors or creditors in respect of consumer debt. It would appear that if it is of any relevance at all, this would be primarily in the context of (small) business debt. But since there is a 12 year waiting period before a discharge is achieved, we do not find it appropriate to consider the Irish bankruptcy law as a consumer insolvency procedure. There appear to be no government proposals for reform, though a debt settlement approach has been proposed by voluntary groups (FLAC research/West-North west submission).

In *Italy*, a Reform Committee of Bankruptcy Law is working at the moment. It is anticipated that there will be a new regulation on consumer insolvency but as the committee works in secret, information is not available.

In *Portugal*, two proposals have been put forward. The Ministry in charge of consumer protection set up a Commission to draw up a consumers' code in 1996. The Ministry submitted the part of the Commission's proposal corresponding to the remedy for overindebtedness for public discussion (in 1998 and as a revised version in 2000). During this consultation, another Ministry, the Ministry of Justice, asked the Permanent Observatory of Justice (Observatório Permanente da Justiça) for another proposal that was published in 2001. There are current discussions about the introduction of consumer insolvency legislation going on in the Portuguese Parliament.

One proposal is that the Code of Special Procedures for Company Recovery and Bankruptcy of 1993 is revised to include the Regulation of Procedures for the Restructuring of Liabilities of Overindebted Individuals. Recent news indicated that the Government's project intends to create the opportunity for an insolvent debtor to present to the court a payment plan proposal along with the bankruptcy petition, this to be approved by 2/3 of creditors identified by him.

The first consumer insolvency proceedings in Europe was adopted in *Denmark* as the Bankruptcy Act (*Konkursloven*) was amended to include a new chapter on debt adjustment (gældsanering §§ 197-237) which became effective in 1984. The Danish society ex-

pressed deep and general satisfaction about their law after it had been in operation for only a few years. The law was an important example when other Scandinavian consumer insolvency laws came into force at the beginning of the 1990s.

Finland adopted the Act on the Adjustment of the Debts of a Private Individual. Its effective date is 8 February 1993. It was amended in 1997 and in 2002. There are no proposals for reform at the moment.

In *Sweden*, the Adjustment of Debts Act (Skuldsaneringslagen) came into force on 1 July 1994. The Adjustment of Debts Act will be reviewed by a committee which will propose improvements. The committee has recently started its work and will present its conclusions in 2005.

Austria has special regulations which are incorporated in the Bankruptcy code. This is the third part of the Bankruptcy code, Special Regulations for Natural Persons, First Main Piece: Bankruptcy and Debt Adjustment Procedures. It became effective on 1 January 1995. No amendments are pending.

Germany has the Insolvency Act (Insolvenzordnung - InsO) of 5 October 1994 (BGBl 1994 I, 2866). It became effective on 1 January 1999. Consumer Bankruptcy is just a part of the Insolvency Act (§§ 304 ff. InsO), which is primarily geared to the needs of insolvent companies and not of insolvent consumers. Consumer insolvency proceedings were reformed for the first time in 2001. A second reform is presently under discussion and is planned for 2004.

The *Netherlands* has the Consumer Bankruptcy Act which is incorporated in the General Bankruptcy Act. It became effective on 1 December 1998. Amendments are currently being prepared.

Belgium has the Law of 5 July 1998 on the collective settlement of debts which came into force on 1 January 1999. A Bill seeking reform of the collective debt settlement procedure has been presented but has not yet been debated in parliament ("Proposition de loi modifiant le Code judiciaire en ce qui concerne le règlement collectif des dettes" (Documents parlementaires, Chambre, 2002, n° 2149/001)).

In *Luxembourg*, the Law of 8 December 2000 is applicable. This consists of a) the prevention of overindebtedness and introducing a procedure for the collective settlement of debts in cases of overindebtedness; b) amending Book 1, Chapter 1, art. 4 of the New Civil Procedure Code. The effective date of the Law is 8 December 2000 too. However, given the lack of Grand-Ducal Regulations in



relation to enforcement, the first formal application to engage in the procedure was not signed until the end of 2001.

In *France*, the Law on Prevention and Regulation of Overindebtedness was enacted already in 1989. Its effective date is January 1990. It applies to all debtors who are not subject to other legislation (such as the laws relating to business or agricultural insolvency). This law is not a proper consumer insolvency law because it has a very limited provision on discharge. Discharge is available only in hardship cases and only after a three year waiting period.

However, the law of 1 June 1924 introducing *French* Company Law into Alsace and the Moselle départements is still in force and applicable to non-business debtors who reside in these departments, who may choose between the two legislative frameworks. Several consumer associations are lobbying for the national Law on overindebtedness be changed to correspond to the law of Alsace et Moselle for all consumers. Minister Jean-Louis Borlog has put the proposal before the French Parliament and it is expected to be discussed in June 2003 and voted on in July 2003.

II.D.2 Philosophy

II.D.2.a) Fresh Start

In all Member States, which have a consumer insolvency law, the idea of a fresh start for debtors has been expressed in legislative bodies and in the general discussion about the law. The purpose is that a debtor can through the consumer insolvency procedure gain back the command of his economic affairs. After the legal process and the payment plan the debtor would be “rehabilitated”, that is to be able to act in the economic life as anyone else.

The concept of a fresh start as discussed has a **different meaning** from that which it has in the **United States**, where the concept originated. In American legal usage, the concept of fresh start refers to a right to be discharged from pre-bankruptcy debt in fairly quick and formal bankruptcy proceedings.

This difference can be traced back to (business) bankruptcy law. As bankruptcy is acknowledged in the US Constitution (1789), discharge is historically an essential part of the American bankruptcy law. Likewise discharge belongs to the domain of bankruptcy law in other Anglo-Saxon countries as well even though it is not necessarily as clear cut a right as in the United States. For example, in *England* and *Ireland* bankruptcy proceedings have retained some of their repressive character, but nevertheless the debtor may be freed from liability for pre-bankruptcy debt after a certain number of years have passed.

The historical context in *Continental Europe* has been quite the opposite. Discharge has not been part of bankruptcy law. Compositions have been known, but they have required an acceptance by a qualified majority of the creditors. In the main, bankruptcy debtors still have a fair amount of debt after the bankruptcy. This is quite a striking difference compared to company insolvencies which are final, and a new business activity by the owners is not encumbered by old debts. Lately, after bankruptcy cases in Continental Europe, there have been some signs of a reversal of this rule of unlimited liability. For example, the *French Insolvency Law of 1985*²⁰⁴ makes discharge possible in many cases. The French Insolvency Law, which is generally only applicable to natural persons who have been merchants, is in certain provinces (Alsace) applied to all consumers. Thus, there is a region in Europe in which a consumer can receive discharge in bankruptcy proceedings.

Also in the *United Kingdom* and *Ireland* a discharge can be obtained in bankruptcy proceedings. In the UK the discharge period is two to three years and discharge thereafter is the norm. In Ireland, the discharge is obtained after twelve years of bankruptcy. These bankruptcy proceedings are not accessible to consumers because of high costs, but some former business men have benefited from them.

Furthermore, the *German* and *Austrian* solution to incorporate consumer insolvency proceedings into the bankruptcy can be interpreted as an attempt to alleviate the strict post-bankruptcy liability. In these countries the special debt arrangement at the end of bankruptcy aims at discharge but only after a lengthy payment plan.

Thus, the American notion of fresh start has not been accepted in any of the Member States, neither in bankruptcy nor in consumer insolvency law. Rather, the discharge of debt is conditioned, in particular by a partial payment obligation but also by a number of requirements concerning the debtor's behaviour. It would therefore seem appropriate to use the term "**earned start**".

II.D.2.b) Earned Start

When a payment plan is an essential part and condition of the discharge, we can speak about an earned start. A payment plan is required in all Member States which have consumer insolvency regulations. The duration of the plan varies from three years in

204 Loi 85-98 du 25.1.1985 relative au redressement et à la liquidation judiciaire des entreprises

Denmark to seven years in *Austria* and even more in the *United Kingdom*. The most common maximum duration of the plan is five years. Even though shorter plans are allowed in accordance with the laws of most countries, the maximum duration of the plan seems to be the most commonly used length of plan in most Member States.

In some Member States, the requirement for a mandatory payment plan has caused problems for debtors who have no payment capacity at all. At the one extreme is *France*, where discharge is granted only to debtors with no prospect of paying at all and even they can receive it after a waiting period of three years.²⁰⁵ In some countries, zero payment plans are accepted but the debtor has the same status as other debtors during a plan period, including the same reporting etc. duties (see further in subchapter II.D.4.e)). Somewhat exceptional is the situation in *Austria* which has a very stringent requirement for a minimum payment of ten percent of the total debt. This rule seems to exclude the poorest debtors from consumer insolvency proceedings and is therefore considered unjust.

As these examples show, and as will be explained in more detail in subchapter II.D.4.e), European insolvency laws require that **the new economic start is earned through a long and demanding payment plan**. This requirement seems to be more of a manifestation of the importance of “**good payment morals**” than of economic interest of the creditors. The yields of the payment plans are never big and in most cases they are quite modest. Some studies have shown that the average outcome to creditors is about 15% of total debt outstanding. It requires quite a large amount of administrative and judicial work to draw up a plan and to monitor it. Therefore the economic rationale of such plans sometimes seems questionable, this being most obvious in the case of zero-plans. The payment morals, on the contrary, are very much emphasized in European discussions on consumer insolvency regulation. Therefore, our conclusion is that the payment plan also manifests the European moral attitude towards payment of debts.

II.D.2.c) Re-education

There seems to be a common understanding among the Member States that the debtor should regain control over his financial affairs during the consumer insolvency procedure. The underlying idea seems to be that since he has mismanaged his financial af-

205 The law was amended to include this discharge provision in 1998; Loi 98-657 (29 July 1998).

fairs before the insolvency he should change his habits in order not to do it again. Therefore, the procedure should have some educational features. Often, for example, the payment plan is seen as an educational tool, but the debtor is also considered to require specific counselling in financial and budget skills.

Since the consumer insolvency procedure is in most Member States linked with or preceded by participation in debt counselling, there seems to be a fair chance for re-education (see subchapter II.D.3.a) below).

There was a long tradition of debt counselling services in some Member States before any consumer insolvency proceedings were discussed. Most notably, debt advice has been organized through consumer advisors and social workers in *Sweden*, different consumer, welfare and social organizations, and even labour unions and churches in *Germany* and in connection with the municipal banks in the *Netherlands*. In most cases, it has been individual advice and counselling on budgeting, financial management and support in negotiations with creditors. Financial literacy education for groups or in educational institutions still seems to be at an initial and experimental stage.²⁰⁶

When consumer insolvency laws were enacted, resources were allocated to debt counselling. Debt counselling also acquired a new status when linked with the insolvency procedure in a direct or indirect way (for more details see subchapters II.D.3.a) and II.E.1). The content of debt counselling usually changes when a consumer insolvency law is enacted: The preparation involved in filing for insolvency becomes a task for debt counsellors. In many organizations, counsellors still try to use some of their time for budget advice and to change the consumption habits of debtors. Often the pressure to prepare filings for insolvency to the court is, however, so pressing that traditional debt counselling tasks are left in the background.

The field of financial literacy education is, however, developing worldwide. It has been made obligatory in consumer insolvency proceedings in Canada. Also some districts in the United States favour educational programmes for consumer bankruptcies (see also subchapter I.B.2.c)(2) above). The educational approach is also favoured by European legislators and we can expect that the incorporation of financial literacy education into consumer insolvency proceedings will also be one of the topics that will be discussed in Europe during the coming years.

206 For more details see subchapter II.E.3

II.D.2.d) Rehabilitation

The best way to describe the aims of European consumer insolvency laws is rehabilitation. The overall purpose is to change the debtor's financial situation and put him back in control of it. This could be achieved through partial payment of debt, discharge of the rest, and through appropriate counselling.

To achieve rehabilitation, it is first of all important that all of the debtor's debts are included in the discharge proceedings. As will be discussed later (subchapter II.D.4.c)) insolvency proceedings indeed cover most kinds of debt, even though important exceptions exist.

It is also essential that the debtor is able to return to normal financial transactions after the insolvency and preferably during the payment plan phase. In practice, former bankrupts and consumer insolvency debtors are often discriminated against in the credit market, in housing, in employment and in new businesses. There seems to be no general prohibition against discrimination in any of the European consumer insolvency laws. The data protection laws, however, restrict to some extent the use of information about completed insolvency plans. The legal policy makers have not yet paid attention to the discrimination problem but as there are more and more debtors who have completed their plan, pressure towards anti-discrimination measures may become acute.

II.D.2.e) Punishment

Punishment of debtors is clearly not among the aims of consumer insolvency regulations. This is a clear distinction in the bankruptcy laws of some countries in that punitive measures, such as restrictions on access to credit and prohibitions on acting as executives of companies, are still connected with bankruptcy.

There are, however, characteristics that add a flavour of social control to many consumer insolvency procedures. For example, *Scandinavian* laws regulate access to the debt adjustment procedure with moral attributes, and the exclusion of certain debtors as a result of excessive borrowing has a punitive character. Under *Austrian* and *German* law, the social control of the debtor is linked with the payment plan since the debtors behaviour during the plan is assessed after completion of the plan, and the discharge may be dismissed in the case of misbehaviour.

II.D.2.f) Terminology

Insolvency law is a fairly recent term which is increasingly used for the area of law which covers collective insolvency procedures, including traditional bankruptcy, modern business reorganizations,



and increasingly also consumer bankruptcies or debt adjustment proceedings. The terminology in the field varies. Both business organization and consumer bankruptcy are regulated under quite different titles in different Member States.²⁰⁷

The term consumer bankruptcy, which is widely used in the Anglo-Saxon countries, has not been accepted in Europe. Consumer bankruptcy can be understood as referring to a proceeding which offers a quick and formal discharge of debt. To underline the different conditions attached to the discharge in European laws, a different terminology has also been used.

The legal context of consumer insolvency proceedings also varies. In some countries the proceedings are regulated by the bankruptcy or insolvency law (*Austrian* Konkursgesetz, *German* Insolvenzordnung and *Danish* Konkurslov). Even in those countries, debt discharge proceedings are distinguished from the general bankruptcy proceedings by a special title; Restschuldbefreiung in *Austria* and *Germany*; Skuldsanering in *Denmark*.

Most Member States have enacted special laws to cover consumer insolvency. The proceedings are called debt adjustment, debt arrangement or debt consolidation proceedings (see table 6). In *Scandinavian* languages, reference to the term (skuld)sanering which is usually used in the business reorganization context is made either in the title of the law or in general usage.

This report decided to respect these differences in terminology and to use the term consumer insolvency law and proceedings to cover all the relevant procedures. As consumer insolvency law the following chapters consider such laws that lead to a partial or total discharge of debt, that are accessible to consumer and other private debtors at reasonable cost and that include debtor's assets, future income and all debts in the same arrangement.

II.D.3 Systems

II.D.3.a) Out-of-Court Systems

II.D.3.a)(1) Considerations for Out-of-Court and Court Proceedings

In legal policy deliberations around consumer insolvency, a preference for informal, out-of-court solutions to individual cases of overindebtedness has been clearly expressed. Several reasons for this preference have been mentioned: Informal, negotiated solutions are considered more flexible and provide the opportunity of

²⁰⁷ see also Table 2: Definitions of Insolvency and Table 3: Definitions of Overindebtedness

tailoring a payment plan according to the needs of an individual debtor and others involved, including those who have given personal guarantees for loans. Since court fees and costs for legal aid are saved, out-of-court solutions should offer creditors the chance of a better solution. There should be less stigma and less adverse influence on the debtor's future affairs because informal negotiations are not public and not registered in credit information systems. These aspects should also give the debtor incentives to offer a better outcome to creditors through informal negotiations as opposed to the minimum required in the courts.

There are, however, serious reasons why insolvency proceedings are court proceedings. Insolvency proceedings, including bankruptcy, business reorganization and other proceedings concerning insolvent companies and businessmen, include several elements, which require court involvement. Firstly, the opening of insolvency proceedings curtails creditors' rights to debt collection and enforcement in such a way that they can be ordered only by a court. Secondly, in involuntary proceedings initiated by a creditor, the debtor either loses control over his financial affairs or this control is strongly curtailed, which effect can not be achieved through any agency other than the court. Thirdly, orders given in insolvency proceedings also concern those creditors who have not been heard in the proceedings (unknown creditors). This always requires a decision by a court. And finally, the outcome of the insolvency regulates the rights of the involved parties in such a way that it can only be done by common agreement or by a decision of the court.

These same concerns about the rights of the debtor and his creditors also prevail in consumer insolvency proceedings. Therefore, orders that curtail the rights of the parties against their opinion or which are given without a proper hearing have to be made by the court.

II.D.3.a)(2) The Present State of Law

The legal policy solution to these contradictory arguments has been to design consumer insolvency proceedings which include both informal out-of-court procedure and, in the event of no solution being reached voluntarily, a full insolvency procedure in the court. Almost all European consumer insolvency laws consist of a two-tier procedure. *Denmark* and the *United Kingdom* seem to be the exceptions; neither country requires a pre-court attempt at settlement.

In most countries the debtor first has to make an attempt to reach a settlement with his creditors in more or less informal proceed-



ings. A general rule is that the opening of a consumer insolvency procedure in the court is only possible if the prescribed pre-court procedure has been completed.

The detailed design of these pre-court proceedings varies a great deal. At the one end are those systems in which the only requirement is that the debtor has made an attempt to reach a settlement with creditors voluntarily. In *Finland*, the negotiations are not regulated and the debtor's statement that a certain creditor is not willing to negotiate is sufficient proof of a failed attempt at an amicable settlement. In *Germany*, the courts require that the debtor provides a certificate of the failed pre-court negotiations given by an authorized debt counsellor or lawyer. Also in *Austria* the pre-court negotiations generally have to be under the auspices of an authorized counselling agency.

In the *Netherlands*, the tradition of voluntary settlements was well established before a consumer insolvency law was enacted in 1998. The negotiations were carried out under the auspices of the municipal banks. Professional debt managers (debt counsellors) negotiated the settlement, local social services took an active role and local governments could come forward by providing funding for the settlements. The enhancement of voluntary settlement between a debtor and his creditors was an explicit goal of the new consumer insolvency law in 1998. The consumer insolvency law requires that an attempt to reach a voluntary settlement with the help of the debt management agency has to be made before the debtor files in the court. Because of this infrastructure and tradition, voluntary settlements are reached in a considerable number of cases in the Netherlands. Despite of a growing number of cases, debt managers were able to reach a voluntary solution in 28 per cent of cases in 2000.

In most countries, voluntary out-of-court settlements are a clear priority when the reform process starts. Just a few years ago in *Ireland*, a country without legal consumer insolvency, the consumer advice organization Money Advice and Budgeting Services (MABS) and the organizations representing some institutional creditors started an ambitious program for voluntary settlements in consumer insolvency cases. Also the reform discussions in *Portugal* are structured around a judicial court procedure, proposed by the Commission to the Ministry of Consumer Affairs in 1998, and an extrajudicial procedure proposed by the Permanent Observatory of Justice to the Ministry of Justice in 2001.

In most other countries the pre-court procedure is more regulated and institutionalized. In *France*, debtors file their rescheduling application with the commission, consisting of representatives of



Banque de France, local banks, consumer groups and the administration. The commission then makes extensive inquiries into the debtor's affairs, facilitates negotiations with the creditors, and sets up a plan for acceptance by the parties (plan conventionnel). The commission's aim is to win the creditors' support and avoid court proceedings.

The proposal which is to be discussed in the French Parliament in June 2003, aims at strengthening the commissions by adding a lawyer and a social worker to them. The proposal retains the central role of the commission, but gives wider powers to grant discharge to the courts.

Luxembourg has a somewhat similar system with commissions as the first instance and courts as the second, with wider powers to discharge than in France.

Also in *Belgium*, the pre-court procedure is closely tied to the court proceedings. The filing is made to the judge who appoints a mediator to propose and negotiate a plan. If the creditors do not accept the plan, it may be confirmed by the judge.

In *Sweden*, all filings are made with the debt enforcement authority (knofogdemyndighet). Often before the filing, debtors have already contacted debt counsellors or social services in an attempt to find a solution to the debt problem. The enforcement authority may open the insolvency proceeding or dismiss the filing. If the proceedings are opened the enforcement authority drafts a plan and proposes it to the creditors. If the creditors oppose the plan, the enforcement authority may not confirm it and the debtor files in the court. Overall, the decisions of the enforcement authority may be appealed against in the district court.

An important difference among the pre-court systems is that more institutionalized pre-court proceedings may be connected to the court proceedings so that the debtor may be granted relief from creditors' debt collection efforts during the pre-court stage of the proceedings (see subchapter II.D.4.a)).

In some cases the length of the pre-court proceedings is limited by law. This is the case in those countries in which pre-court proceedings are institutionalized and connected to the court. Especially if the creditors' rights to debt collection and enforcement are curtailed, there is a legitimate interest to limit the duration of the negotiations. For example, this stage should be finalized in four months in Belgium, in two months in France and in six months in Luxembourg.

II.D.3.a)(3) General Considerations



As a general rule, the plan can not be accepted in the pre-court proceedings unless all creditors accept it. Thus, the opposition of just one creditor precludes a voluntary payment plan in the pre-court proceedings. Sometimes one institutional creditor, for example a debt collection agency or tax authority, may take a very cautious stand towards voluntary settlements and consistently oppose most proposed settlements. Such systematic attitude forces debtors go to court.

In those systems in which the pre-court payment plan is a contract due to its legal nature, creditor passivity also makes acceptance of the plan difficult. When a pre-court system is more institutionalized, a different attitude towards creditor passivity is possible. For example, in *Sweden* and *Germany* where pre-court procedure is run by the enforcement authorities, the creditors who do not oppose the plan are assumed to have accepted it. When creditors are notified of the proceedings, they are reminded of this rule. In *Sweden*, the level of consumer insolvency is quite low, but it is worth noting that about one third of applications have led to confirmation of the plan by the enforcement authority in the pre-court procedure. In *France* and *Luxembourg* too, a plan proposed by the commission can be accepted more informally if it has not been opposed by any of the creditors. Clearly, in these countries, over half of the cases are settled at this stage.

The **success rate** of pre-court proceedings is extremely difficult to measure. Even the concept of voluntary settlement is ambiguous. Many institutional creditors point out that re-negotiation of credit agreements is for them a normal course of business. More institutionalized settlements, however, include all the creditors of one debtor and require the professional assistance of the debtor.

Some European countries indeed produce interesting successful results in institutionalized negotiation processes between debtors and their creditors. For example, one third of proposals have been accepted by creditors in *Austria*. Although it must be stated that this rate has dropped after the "Konkursordnung" entered into force. Also in *France*, two thirds of plans have received support from the debtor and the creditors. Both in *Germany* and the *Netherlands* the rate of acceptance has dropped after the consumer insolvency law came into force. In *Germany* debt counsellors were able to negotiate a voluntary settlement in more than one third of the cases before the law and now the rate of acceptance has dropped to 15 per cent.²⁰⁸ In the *Netherlands*, the rate of acceptance is reported to have dropped from 40 per cent to 28 per cent.

208 This is an estimate which is not based on a representative study.

At the same time, however, the number of filings has increased by more than 50 percent, which means that the number of voluntary settlements has actually remained the same.

There are no unambiguous criteria to evaluate these numbers. If the rate of voluntary settlements has dropped when the purpose of the consumer insolvency legislation has been to encourage such settlements, the outcome is certainly disappointing as happened in the *Netherlands* and *Germany*. All these figures, however, show that under favourable conditions voluntary settlements can be reached. Since voluntary settlements are the preferred political goal, some significant contributory factors should be mentioned.

Firstly, institutional support seems to be important. Professional, low-cost or cost-free assistance has to be available, preferably with experience in negotiations with creditors. The counsellors or mediators have to have credibility in both debtors' and creditors' eyes. Secondly, the negotiations need support from the court. The enforcement process should be stopped while the negotiations are pending, which requires involvement by the court and also setting of deadlines for the negotiations. Thirdly, creditor passivity should not prevent the acceptance of the settlement, which should be binding on all creditors who have been duly notified.

The possibility to design the plan individually to suit the situation of the debtor is often mentioned as one major advantage of the out-of-court settlements. In theory, the guarantors, co-debtors and other securities could be included in voluntary, individually negotiated settlements. Such settlements can also make exceptions to equal treatment of creditors and adjust the plan to the circumstances of the debtor. The debtor might be willing to accept a longer plan or bigger sacrifices than required by law in order to avoid the inconveniences of the court procedure. Creditors too should accept a settlement in order to avoid court costs. These factors can be seen as benefits of voluntary settlements but they do not seem to be enough to motivate creditors to accept plans. Creditors seem to be more interested in the institutional guarantees of due process that stem from court proceedings. Also, the advantages of voluntary settlements can be utilized only if the mediators who advocate them are aware of the available options. Thus, if voluntary settlements are to be enhanced, they have to be supported by institutional safeguards.

II.D.3.b) Court-run Systems

The court-run systems form the second tier in consumer insolvency proceedings. The consumer insolvency procedure in the court is, in most countries, quite a traditional insolvency process in



which all creditors of a debtor are included, in which a decision of the distribution of the disposable assets the debtor may have is made and in which the decision about the use of the debtor's future income to pay part of his pre-bankruptcy debt is made. In the end, the debtor is discharged of the liability to pay the rest of the pre-bankruptcy debt.

There seems to be some differing opinions about the systematic placement of consumer insolvency laws. Consumer insolvency can be regulated either in general bankruptcy law or in special legislation aimed at consumer insolvency cases. This classification, however, is not very practical from the consumer's point of view. Insolvency proceedings are relevant from a consumer debtor's point of view if the procedure includes a discharge provision and if they are accessible to consumers.

As was indicated above, in *France*, *Ireland* and the *United Kingdom*, general bankruptcy law includes a possibility to discharge. In Ireland, the discharge is obtained only after 12 years and even then some restrictions on the debtor remain. Therefore, this can hardly be counted as a consumer insolvency regime. In France, bankruptcy is not at all available to consumers. In the United Kingdom, the costs of bankruptcy proceedings make them unavailable for most private persons but in some cases it has been used quite successfully.

In consumer insolvency regimes, the *Austrian* and *German* procedures are most closely to general bankruptcy and insolvency law. In these countries, consumer insolvency is part of general bankruptcy and insolvency law, and the discharge requires that the consumer goes first through formal, albeit simplified, bankruptcy proceedings.

In most other countries, consumer insolvency is regulated in a special law, which is called Consumer Debt Adjustment Law or Skuldssanering to distinguish it from bankruptcy proceedings. In some countries, particularly in *Belgium* and *France*, consumer insolvency proceedings are more closely linked to the prevention of overindebtedness. The relevant law also contains other, preventive measures and it is entitled Law on the Prevention of Overindebtedness.

Notwithstanding these somewhat different approaches, consumer insolvency proceedings resemble traditional bankruptcy proceedings quite closely.

Usually the opening of consumer insolvency proceedings is publicized in official journals and recorded in the credit information register. As in ordinary insolvency proceedings, the creditors are re-

quired to submit their claims and have the opportunity to make objections to the other claims and to the plan. The most striking difference compared to traditional bankruptcy proceedings is that the aim of the consumer insolvency process is the confirmation of the plan and that the plan can be confirmed by the court irrespective of creditor acceptance.

There is also some variation in the court proceedings in different Member States. There are actually two alternative court proceedings in *Austria* and *Germany*. First, the court tries to reach a composition plan which requires an acceptance by the majority of the creditors. If this attempt is not successful or if the court sees no prospect in it, a trustee is appointed. The trustee oversees that the debtor's assets are used to pay the creditors. Then the debtor's wages are assigned to the trustee for the payment plan period. The trustee distributes the money to the creditors. The legal conditions for the content of the plan (see subchapter II.D.4.e)), the involvement of the creditors and the administration of the process is quite different in these two proceedings.

In *France*, the filing is first made to the Commission of Overindebtedness and only if it fails to reach an agreement, can the file be transferred to the court. The proposal which is to be discussed in the French Parliament in June 2003 would make a "fast track" for such cases in which the Commission sees no chance of success under the voluntary settlement procedure. These cases would be transferred directly, with the consent of the debtor, to the court which would have powers to grant discharge.

The several stages of proceedings seem to be the object of some criticism in those countries that have two institutionalized proceedings. The purpose of creating two or more consecutive stages in proceedings is always to encourage parties to accept a plan in the first, less bureaucratic stage. This aim seems to be quite difficult to achieve and there is always a danger that the first stage becomes just a preparation for the more judicial second stage.

II.D.3.c) Discharge and Post-Insolvency

The goal of all European consumer insolvency laws is a discharge of pre-bankruptcy debt at the end of the payment plan. In most systems no special application for discharge is required from the debtor at the end of the payment plan. Thus, the remaining debt is conditionally discharged when the payment plan is confirmed.

In *Austria* and *Germany*, however, a special court hearing (discharge hearing) is held at the end of the plan to evaluate the plan fulfilment. In some other countries, the plan may be cancelled if the debtor does not fulfil his obligations according to the plan.



Both *French* and *Belgian* law have a restrictive attitude towards discharge. In both countries, the priority is to achieve a settlement in institutionalized pre-court negotiations between the debtor and his creditors. It is emphasized that in this procedure the content of the settlement can be freely formulated to include a discharge of the outstanding debt, including the outstanding principal. The court, on the contrary, has only limited powers to discharge the principal. Preference is given to other measures, such as the postponement or rescheduling of debts, the reduction in the contractual rate of interest to the legal rate of interest, suspension of the effect of security and assignments of credit and the remission of interest on arrears, indemnities and charges. In Belgium, the judge may also discharge part of the principal, but this measure should be reserved for the most extreme cases. In France, discharge of the principal is only possible in hardship cases after a three year grace period.

A change in attitude towards discharge is taking place in *France*. At the initiative of consumer organizations, a legal reform is now pending in the Parliament. In the provinces of Alsace & Moselle, private persons have been eligible to file for bankruptcy and to receive discharge of debts in bankruptcy. Such civil bankruptcy has been an inspiration for a proposal to widen the access to discharge in the whole of France. The proposal that will be discussed in Parliament in June 2003 proposes a power to the court to grant discharge to those debtors who have no prospect of reaching a voluntary settlement with the help of the commissions.

The extent of the discharge is conditioned by which debts are included. The general rule in Europe seems to be that most debts are included in the insolvency process and, thus, discharged. The exceptions and special regulations are discussed further in subchapter II.D.4.c).

This rule, however, applies only to court proceedings and other regulated proceedings. Voluntary settlements are, of course, binding only on those debtors who have agreed to the settlement. For example in *Austria*, there have been instances where creditors who have not agreed to the payment plan have tried to collect debts later on.

The fresh start may also be hampered if the insolvency debtors are discriminated against after the discharge. There has not been research on whether discrimination is a problem in practice but anecdotal evidence suggests that discrimination may be a problem in many cases. Possible contexts in which discrimination may occur are opening of bank accounts, granting of new credit, starting new

businesses, employment, signing new contracts, especially lease contracts etc.

Interestingly, none of the European consumer insolvency laws contains a non-discrimination clause. This certainly does not indicate that any discriminatory treatment would be justified, but rather that the law makers have not been aware of potential problems. Since the purpose of the consumer insolvency legislation is rehabilitation and a fresh start for debtors, discrimination against discharged debtors is clearly against the rationale or purpose of the legislation. It has to be admitted, however, that some differential treatment during the payment plan may be justified concerning, for example, new credit. But after the plan has been completed such differentiation obviously means unjustified discrimination.

These kinds of effects of consumer insolvency proceedings to a high degree depend on the registration of credit information. All Member States have sophisticated systems of registration of credit information and regulation of data protection. It seems to be of utmost importance that the Member States should have adequate regulations of data protection regarding information about both ongoing and completed payment plans. Information about completed payment plans should not generally be allowed to stay in credit files.

II.D.4 Central Issues of Consumer Insolvency Law

II.D.4.a) Stay of Enforcement

The opening of a formal insolvency proceeding has the effect of stopping debt collection efforts by the creditors, including informal debt collection, legal processes and the enforcement of judgments. In bankruptcy law this effect is usually connected with the debtor's bankruptcy filing and to the decision of the court to open a bankruptcy as a consequence of a filing by a creditor. In consumer insolvency, however, a filing by a debtor does not have such legal effect. The stay of enforcement follows from a decision to open insolvency proceedings by the court. In *France*, the debtor must file for a stay of enforcement to the judge for civil debts and to the tax office for fiscal debts to get protection while the case is handled by the commission.

In theory, the stay protects the equality of the creditors because the creditors are not able to pressure the debtor for disproportionate payments after the stay is in effect. In addition, it gives some leeway to plan for rehabilitation. For a private debtor the stay also gives a necessary breathing space often in a very stressful situation. If the stay covers mortgage debt and realization of collateral, the most important practical purpose of the stay in consumer in-



solvency proceedings is the protection of home against foreclosure and forced sale.

Since the consumer insolvency laws in the Member States have very different regulations about the pre-court proceedings, the stay of enforcement is also connected to different stages in the proceedings. In some countries a court can order the stay of enforcement to protect negotiations in pre-court proceedings (for example *Sweden*, *France* and *Luxembourg*). In most countries, however, such protection is not available (for example *Austria*, *Finland* and *Germany*) and the stay is given effect only when the formal court proceedings are opened.

There are also differences in the scope of the stay. Usually, informal collection efforts and formal enforcement of debts are stopped. The debtor is not allowed to pay pre-insolvency debts. The stay does not necessarily cover secured debt. Such is the case in *Austria*. But when the debtor may keep the collateral, especially his home, such protection may even be given (*Finland*). In *Germany* too this seems to be possible, although not for immovable property.

If the debtors wage is garnished, the stay may affect the garnishment. In *Germany* wage garnishment becomes invalid. In *Finland* the debt enforcement authority continues to collect the garnished portion of wages and it is distributed to the creditors according to the plan. A special regulation exists in *Austria* and *Germany* where wage assignment “rides through” the insolvency, that is, the assignment of part of wages to a certain creditor (in particular banks) remains in force during the insolvency process and the first two years of payment plan. In *Austria* too, an employer’s set off claims enjoy this kind of privilege.

In *Austria* social security institutions are allowed to set off irrespective of the stay. In *Finland*, set off is allowed for the tax collection.

Also, maintenance or alimony creditors, who are often excluded from the discharge, are often excepted from the stay (*Austria*, *Germany*, *Luxembourg*).

It has to be noted that the stay does not protect other persons liable for the same debt, such as guarantors or co-debtors.

II.D.4.b) Access/Good Faith

II.D.4.b)(1) Insolvency Requirement

Access to consumer insolvency procedure and discharge is subject to the discretion of the court in all Member States. The conditions



for discharge can be distinguished as the insolvency requirement and the condition of good faith or *bonne foi*.

The insolvency requirement corresponds to the bankruptcy law according to which a debtor is considered insolvent and thus bankrupt if he is not able to pay his debts as they fall due. In *Austria* and *Germany*, where consumer insolvency is tied to the formal bankruptcy proceedings, the insolvency requirement is identical with the bankruptcy law requirement. In many other countries, the concept of insolvency has a somewhat different interpretation or additional requirements in the consumer insolvency context.

First, the interpretation of insolvency requirement in consumer insolvency always takes place when the debtor has filed for insolvency in order to get discharge. Thus, the courts exercise control over the insolvency requirement. If the debtor is not deemed to be insolvent "enough", the filing can be rejected by the court. In the interpretation of the insolvency requirement, the time perspective is usually longer than in bankruptcy law where insolvency is deemed to exist if the debtor is unable to pay his debts as they fall due.

Some countries explicitly require qualified insolvency from a consumer debtor. Especially in *Denmark*, the debtor has to be "hopelessly" in debt; that is to say, he has to prove that he is not able and within the next few years has no prospect of being able to fulfil his obligations. This requirement was earlier interpreted as requiring debt at least to the value of 30,000 euros.

A more usual interpretation is to compare the amount of debt to the payment capacity of the debtor. In *Finland*, the debtor's insolvency is also scrutinized by the court. In *Sweden*, the criteria include other than temporary inability of the debtor to repay his debts as they become due.

In *France*, the concept of overindebtedness is defined as "the manifest impossibility for a debtor in good faith to meet his/her debts taken as a whole as they fall due and payable." Case law has attempted to offer guidance to overindebtedness commissions on the application of this definition: the effect on "minimum income requirements" is defined in the Act. In other words, an individual is overindebted if repayment of debts reduces their minimum income requirement (the amount which cannot be seized or the *Revenu Minimum d'Insertion* (income support level)).

In *Luxembourg*, the long term financial difficulties are emphasised.

II.D.4.b)(2) Good Faith



In all consumer insolvency systems, the debtor is required to be in good faith, *bonne foi*. There are, however, differences between the formulation and exact criteria of this requirement and between the rigorousness with which the criteria are pursued.

The good faith criterion is stated broadly and generally in *Germany* (art. 286 InsO) as good faith, in *France* as "*bonne foi*".

In the *Scandinavian* countries, more detailed formulations have been elaborated. In *Denmark* the court must consider the debtor's interest in debt adjustment, the age of the debt, the origin of the debt, the repayment attempts and the debtor's behaviour in the debt adjustment proceedings.

The test is an overall assessment of a series of factors in various constellations and of varying importance. The overall assessment consists of a balancing of the said factors in relation to the total (unsecured) debt.

Also in *Sweden*, the court must consider that there are special reasons for granting adjustment. Consideration is given to the period of and reason for indebtedness and to the efforts by the debtor, to the best of his ability, to reach agreement on an instalment schedule with the creditors.

In *Finland*, the law lists the situations in which the debtor cannot be granted access to consumer insolvency proceedings, including criminal activity or being suspected of such activity, other action against the interests of the creditors, non-disclosure or false information in a preceding execution procedure, a false statement to obtain the credit and this information has been essential in obtaining the credit and reasonable grounds to believe that the debtor will not follow the payment plan. The most reasonable obstacle to discharge is that there are reasonable grounds to believe that the debtor has run into debt in an irresponsible way or with a debt arrangement procedure in mind. This judgement should be based on his way of handling his finances, the source of the debt and the circumstances when running into debt etc.

In the *Netherlands*, the good faith test is performed with the help of a "good faith certificate", which the debtor has to attach to his filing to the court. The certificate is given by the debt mediator or by the municipality. In this certificate the court can find all information concerning the specific situation. Reasons for refusal of admittance to the judicial debt adjustment are:

- (judge must refuse): petitioner can go on paying his debts, group fear that the petitioner will try to disadvantage the creditors, it already applies to him

- (judge can refuse): in the ten years before the petition was presented, or it is plausible that the petitioner did not enter into one or more debts in good faith.

In most countries consumer insolvency and discharge are understood as “once in a lifetime” events. In the *Netherlands*, a filing should be rejected if the debtor had an adjustment during the past ten years and in *Austria* twenty years. In *Finland*, a previous confirmation of a payment plan prevents a new discharge. In *Sweden*, there is no explicit prohibition but the underlying idea is that a debtor is given only one fresh start and a previous discharge is taken into consideration among the general prerequisites for consumer insolvency.

II.D.4.c) Coverage

II.D.4.c)(1) What Debts are included in Discharge?

For the fresh start it is important that all or most of the debts are discharged. This is the case with the European consumer insolvency laws. There are very few exceptions to the discharge. When the discharge is granted it covers most debts.

Austria, however, is to some extent an exception to this rule since a number of debts are not included in the discharge. These debts are secured debts, alimonies, fines, torts for damages the debtor has caused and social security contributions.

Common exceptions are the fines and monetary liabilities for criminal or other damages (*Austria, Belgium, France, Germany, UK* bankruptcy in which the courts have discretion in this matter).

Also maintenance debt is not included in the discharge in some countries, for example in *Austria, Belgium, France, Luxembourg* and the maintenance to a child in *Sweden*, child maintenance to Child Support Agency in the *UK* bankruptcy.

In *Germany*, interest-free credit granted to the debtor in order to pay the court fees is excluded from discharge.

Study loans are excluded from discharge in the *Netherlands* and *UK* bankruptcy. In *Sweden*, the discharge of educational loans is subject to the discretion by the court.

Tax debt is included in the discharge in most consumer insolvency regulations. In *France*, however, the commissions do not make payment plans for tax debts but the reduction of tax debt is a matter for the tax office. Also for semi-fiscal debts (TV licence fee), fines and social security debts, the commission has no power to impose repayment of the debt by instalments but may grant a moratorium. Abolition of these exceptions is proposed in the re-

form proposal to be discussed in Parliament in June 2003. After the reform, tax and social debt would also be included in the discharge.

The position of secured debt is not consistently regulated. In many countries, insolvency proceedings do not curtail the rights of secured creditors. If a debt is secured by a personal guarantee, consumer insolvency proceedings have no effect on the liability of the guarantor. The same applies to a person who is co-debtor to a claim on some other ground. The creditor may collect the debt from the guarantor notwithstanding the stay of enforcement. The discharge has no effect on the guarantor or co-debtor who consequently usually ends up paying the debt.

The regulation of property collateral is also not straight forward. In some countries, such as *Finland* and *Germany*, the stay of enforcement also includes debt secured by collateral. The right to payment is secured to the creditor who has collateral at least up to the value of the collateral. If the payment terms of the secured debt can be changed, the range of allowed changes is limited.

In the *Finnish* debt adjustment law, there are special provisions on how the payment terms of home mortgage loans can be altered. The debtor has to pay up to the value of the collateral and the interest rate may be adjusted so that the value of the collateral is protected. The payment period may also be prolonged.

In *France*, where discharge is otherwise only limited, the home mortgage debt which exceeds the value of the house can be discharged. It is feared that the 2003 reform proposal could weaken this protection of the home.

II.D.4.c)(2) Priorities

Equality of creditors or pro rata distribution is clearly the primary rule in consumer insolvency legislation. For example, this main rule is stated in art. 114 of the *German* Insolvenzordnung.

The priority of tax claims has been generally abolished for consumer insolvency proceedings. Exceptions are *Luxembourg* and the *Netherlands* in which priority remains. The abolishment of tax claim priority is in line with a general tendency in European bankruptcy laws to reduce the number of privileged claims. In some cases, such as *Denmark* and *Sweden*, the priorities are abolished for consumer insolvency while some of them remain in business bankruptcy law.

The only main exception from the pro rata rule is alimony and maintenance payments, which are prioritized in many countries, either because they are not included in the discharge at all (*Aus-*

tria) or because they must be paid before other debts (alimony to a child in *Finland*).

Also the costs of insolvency process may enjoy some priority (for example in *Finland*, *Germany* and the *Netherlands*).

In some cases, the court may use discretion in the allocation of payment among the debtors. For example in *Finland*, debts which have been taken to cover the ordinary living costs of the debtor and his family may be given priority.

In *France*, the commissions have wide discretion. They can decide what is in the best interests of the debtor or certain creditors: whether to give preference to debts associated with a tenancy to avoid eviction, to protect small, non-commercial lenders, to ensure repayment of small loans. The commission may also punish creditors who have some responsibility for the indebtedness by asking them to make a greater contribution.

A special element in *Austria* and *Germany* is the assignment of wages, meaning a contract between a debtor and a creditor that gives the creditor a right to demand that the debtor's employer pays a certain part of the wages directly to the creditor. In both countries, this security is valid during the two first years of the payment plan. In practical terms it gives a priority of two years to creditors who have been able to use this "security" and the assignment of wages usually means that all the debtor's seizable income is paid to this one creditor. Mostly this kind of assignment is included in credit contracts by institutional lenders.

This seems to be in contradiction to the principle of equality of creditors. This kind of security is not generally used in other Member States. The garnishment of wages, which means the seizure of certain part of the wages by the enforcement agency to satisfy the creditors, is widely known. This enforcement measure is, however, usually covered by the stay of enforcement (see subchapter II.D.4.a)).

Table 22: Consumer Insolvency Law – Debt and Exceptions²⁰⁹

Member State	Home Mortgage	Alimony	Taxes	Fines	Torts	Study Loans	Other Exceptions, Comments
Austria		no		no	no		wage assigned sustains for two years; social security contributions; debt to employer
Belgium		no			no		living costs
Denmark							equality principle

209 "no" means: debts not included in discharge; "privelege" means: debts paid ahead of other debts

Finland	yes	privilege					alimony to a child privileged; living cost debts privileged if the court decides so; trustees fee privileged
France	yes	no		no			court discretion in allocation of payments
Germany				no	no		wage assignment two years; credit for court fees privileged
Great Britain		no		no		no	in bankruptcy subject to the discretion by the court
Greece	-	-	-	-	-	-	-
Ireland	-	-	-	-	-	-	-
Italy	-	-	-	-	-	-	-
Luxembourg		no	privilege				
Netherlands	no		privilege			no	cost of insolvency process privileged
Portugal	-	-	-	-	-	-	-
Spain	-	-	-	-	-	-	-
Sweden		no 1)				no 2)	1) maintenance to child not included; 2) subject to the discretion by the court

II.D.4.d) Exemptions

Exemption is the term used in (American) bankruptcy law for the property the debtor is allowed to keep in the insolvency procedure. The term illustrates that the right to keep certain property is an exception to the basic principle of bankruptcy law that all debtor's assets are distributed to the creditors. The rationale of exemptions is that the debtor's subsistence should not be destroyed and that he should not be deprived of such tools as make it possible for him to earn his living.

There are two strategies for regulating the exemption in insolvency law. One is to refer to the laws that regulate the enforcement of civil judgments. The other is to stipulate a different exemption list for insolvency proceedings. In the latter case, the insolvency exemptions are usually more generous than those in enforcement law. In such jurisdictions, the rationale of the insolvency proceedings is to protect the creditor from seizure of the property. This rationale has not been clearly evident in European legal reform. Exemptions in consumer insolvency are quite similar to those in enforcement law, even when there is a separate regulation.

The historical background of exemption regulations is in the agrarian society where tangible property was always the most important economic value. Nowadays, the assets of consumers and other private debtors, that are available for sale and distribution among the creditors, are usually not numerous, nor of remarkable value. Notwithstanding, the lists of assets that the debtors are allowed to keep are usually defined quite narrowly and sometimes listed in detail. For example in *Belgium*, the law sets out a fairly detailed list which is applied both in debt enforcement and consumer insolvency and which includes:

- necessary items for everyday life (beds, table, chairs, heating, washing machine, cooker, refrigerator, etc.)
- books and other items used for education
- items essential for the debtor's occupation with a value of up to 2,500 euros
- religious objects
- food and fuel for the debtor and his family for up to a month
- a limited number of farm animals with fodder and bedding for a month

The list also includes the typical groups of items exempted, that is, normal household items, tools for trade, educational materials and some assets of personal value (in this case religious objects). In some countries, it is especially emphasized that the debtor may keep only items that do not exceed a "modest standard of living" (*Austria, Denmark, Germany*).

There seems to be agreement that the debtor's normal household utilities should be exempted from enforcement. As what is considered normal or modest in this context is changing quite rapidly, a general formulation seems to be more preferable than a detailed list. There also seems to be a trend towards more general standards when the laws are reformed.

It is also a general principle that tools are protected. As regards their upper value, there seems to be more disagreement or there are policies in place that have maybe not been carefully considered. Tools may sometimes be fairly valuable. On the basis of the material we have received, it seems to be the case that in some countries there is no limit to the value of tools (for example the *Netherlands*) whereas in some others there is one (see for *Belgium* above). The most important issue in contemporary society, car ownership, seems not to be specifically regulated in any of the Member States, except for *Finland* where a car needed to go to work is treated as tools.

The protection of the home owned by the debtor is part of the exemption regulation, called homestead exemption in American jargon. Protection of the home is closely related to the status of secured debt and the possibility of adjusting secured debt since the debtor's home is usually used as collateral for debt.

The most common approach in the Member States is that home owners enjoy no special protection in insolvency proceedings. In practice, this means that the home has to be sold since it is not an exempted asset. Only *Finland* and *France* have special policies

about homeowners in consumer insolvency. In France, the fact of being a homeowner does not lead to automatic sale. The overindebtedness commission or the judge has to demonstrate that the sale is necessary, which would not be the case if the debtor would have to spend a sum equivalent to his monthly loan payments to obtain accommodation. If the home is sold, there may be a remission of the debts if the sale price is insufficient to repay the debts.

In *Finland*, the mortgage debt for a dwelling can be included in the debt arrangement. Only that part of the debt covered by the value of the collateral at the moment when the procedure is opened is considered secured. The debt exceeding the value of the security is treated as unsecured. The debtor should be able to pay the secured debt according to the original contract or with a minor extension affirmed by the court. If he is not able to do so the creditor may seize the security. The value of the home is estimated by the court.

In *Denmark* and *Sweden*, there are no specific provisions about home-owners in the consumer insolvency law. In practice and jurisprudence, however, the following rules are followed.

In *Denmark*, it is not an essential requirement for debt adjustment that the debtor sells the house in which the family lives. The decisive factors are whether the expenditure on housing is unreasonably high and whether the debtor has a chance of reducing it by moving to another place fulfilling the needs of the household. If the house represents any free value it should be made available to the creditors. Thus, depending on the circumstances, a debt adjustment order may make it possible for the debtor to keep the house.

Mortgage creditors and other creditors with secured claims are not affected by a debt adjustment order in so far as their claims are paid out of the proceeds in the case of a forced sale. The question as to whether or not a forced sale is to take place depends on the ordinary rules and is not affected by the opening of debt adjustment proceedings (outside bankruptcy). To the extent that a secured claim is not satisfied in full out of the proceeds in the case of realization, a personal claim on the debtor is all that is left, and this claim is affected by the debt adjustment order just like any other personal claim.

In *Sweden*, the debtor may keep an owned home, provided that the related costs (maintenance, interest) do not exceed what is considered reasonable. To judge this is complicated, because the creditor often holds the dwelling as collateral. The creditor has to be able to rely on his right of lien, but the court (or the enforce-

ment authorities) may, on certain conditions, decrease the value of the collateral. In practice, if the dwelling has any realization value, the debtor has first to sell it and acquire a cheaper place to live in before there is any point in seeking adjustment of debts.

II.D.4.e) Payment Plan

II.D.4.e)(1) Discharge and the Plan

The typical logic of European consumer insolvency laws is that discharge is “earned” by fulfilling a payment plan. In a way one could say the discharge is conditional on the plan fulfilment. In practice, however, the relationship between the plan fulfilment and the discharge seems to be much more complicated. In process law terms, the *res judicata* effect of the plan varies.

In some countries, like *Denmark*, the *res judicata* of the plan is strong. It is a principle that plans are not changed or annulled in the case of non-fulfilment. Annulment is possible in serious cases of fraud or negligence. The creditors are protected by the right to legal enforcement in the case of non-fulfilment.

In *Germany* and *Austria*, the plans are more conditional. In *Austria*, however, there are two alternatives. If the plan is accepted by a majority of voting creditors, discharge is more or less automatic after the payment. If the plan is accepted by the court, it runs for seven years in most cases (see below). Not only are the debtors payments monitored but also his other behaviour, such as search for employment. At the end of the plan, a special confirmation hearing can be arranged in the court.

There seems to be considerable variation between these two purposes. The conflict between *res judicata*, which is a general principle in procedural law and which has the purpose of promoting respect for legal decision and stability of legally regulated relationships, and creditor protection in cases of non-fulfilment seems to be very difficult to resolve. The main rule seems to be that the plans can be annulled only in very serious cases of non-fulfilment which manifest lack of will to fulfil the plan rather than non-ability to do so.

II.D.4.e)(2) Plan Duration

The average length of the payment plan in Member States is five years. In details, there is again considerable variation.

A five year payment plan is the main rule in *Belgium*, *Denmark*, *Finland*, the *Netherlands* and *Sweden*. The *Irish* proposal for voluntary settlements also assumes five years as a norm for plan duration.

In *Belgium* and the *Netherlands*, the minimum duration of the plan is three and the maximum five years. The duration is not regulated by law in *Denmark*, but in practice the plans are between three and five years. During the first ten years after the law came into force in 1984, the plans were usually three years but now five years seem to have become the rule. In *Sweden*, the law allows some discretion in the duration of the plan but the usual length is the five years as prescribed in the law. In *Finland*, five years is the maximum but shorter plans, which could be accepted when the debtors have already paid a considerable amount through forced sale of home or the like, are very rare. In Finland the plan may be extended by two years to the benefit of private creditors, that is, guarantors for a loan. The plan may also be longer, up to ten years for unsecured debt, when the debtor keeps his homeownership and also pays mortgage debt according to the plan.

A longer plan is required in Germany and Austria. In *Germany*, the plan duration is six years. Before 1.12.2001 it was seven years. In *Austria*, the duration depends on how much the debtor is able to pay. The normal duration is seven years. If the debtor pays more than 50% of the outstanding debt, the discharge may be granted after just three years. If he has not paid 10% in seven years, the plan may be extended by three more years.

In the *United Kingdom*, the County Court Act, which regulates the administration order, does not contain a maximum plan duration and plans have been extremely long in practice. The changes in the law accepted in 1990 but not put into force included a maximum plan duration of three years.

In the United Kingdom, bankruptcy law gives discharge after two to three years. In some cases, the debtor has to make payments according to a plan which usually lasts for the same period. Reform of the Enterprise Act in 2002 reduces the discharge period to 12 months but payment plans should still be about three years. As noted before, the bankruptcy law in the UK is not in practice applicable to consumers. In *Irish* bankruptcy law, the discharge period is 12 years.

Table 23: Consumer Insolvency Law – Payment Plan (Duration)

Member State	Duration	Administration during the plan	Notes
Austria	7 yrs	trustee	3 yrs more if payment less than 10%
Belgium	5 yrs		credit agreements ½ of remaining time
Denmark	3-5 yrs	debtor	
Finland	5 yrs	debtor	2 yrs more for private creditors
France		commission	moratorium only, discharge after 3 yrs in hardship cases
Germany	6 yrs	enforcement	Before 1.12.01: 7 years

Great Britain	7 and more yrs 2-3 yrs	debtor	Administration Orders: no maximum / consumers bankruptcy
Greece	-	-	-
Ireland	-	-	-
Italy	-	-	-
Luxembourg	7 yrs		
Netherlands	3 to 5 yrs	debt manager; trustee	
Portugal	-	-	-
Spain	-	-	-
Sweden	5 yrs	debtor	Some discretion up and down by the judge

II.D.4.e)(3) Living Costs

A most important purpose of consumer insolvency laws is to guarantee the debtor the possibility of a meaningful standard of living. The emphasis in the European consumer insolvency laws is clearly on the quality of life after the plan fulfilment. During the plan, the debtors are required to devote their disposable income to the payment of pre-insolvency debts. The laws specifically regulated how much of his income the debtor is allowed to keep for everyday living. The general principle in these regulations is a very low standard of living.

Actually, most European insolvency laws take as the starting point the minimum level of social security. In practice, this means reference to social assistance which is paid to those people who are not covered by any income-related social security, such as working pensions or work-related unemployment benefits. In the *Netherlands*, debtors are required to live below the social assistance minimum, on 90% of it, but then the general understanding is that the Dutch social welfare is fairly generous. In *Austria*, *Germany*, *Luxembourg* and *Sweden*, the provisions of the law on enforcement of civil judgements are used. This does not make much difference since in these countries the standards of debt enforcement law are not much different from the social assistance minimum.

In *Denmark* and *Finland*, there is a very different situation. Consumer insolvency law requires the debtors to live on minimum level subsistence. In debt enforcement law, however, the situation is different. The debtor's income is not garnished in Denmark for the payment of commercial debts at all and consumer insolvency often means that the debtor's living standard decreases. In Finland, only one third of the net income can be garnished in debt enforcement above a certain level of income. Thus, debtors with high income can live fairly well with garnishment whereas with a payment plan they have to lower their standard of living.

II.D.4.e)(4) Zero-payments

In some Member States the requirement for a mandatory payment plan has caused problems for debtors who have no payment capacity at all. At the one extreme is *France*, where discharge is granted only to debtors with no prospect of paying at all and even they can receive it after a waiting period of three years.²¹⁰ In some countries, zero payment plans are accepted but the debtor has the same status as other debtors during a plan period, including the same reporting etc. duties.

In *Finland*, zero plans are accepted only in hardship cases. A case can be considered a hardship case if the debtor is permanently without payment capacity. At least two years unemployment is required as evidence of permanent inability to pay.

The restrictive attitude towards exclusion of hardship debtors has been questioned in *Belgian* court practice. In Belgium, the law envisages only partial remission of debts, but the Cour d'Arbitrage, in its judgment of 30 January 2003, upheld very firmly the principle that the insolvency of a debtor "does not mean that s/he cannot be re-integrated into the economic system should s/he be granted complete remission, as the judge has the power to impose supervisory measures...".

The Cour d'Arbitrage concluded that the interpretation of the law preventing the judge from setting up a judicial settlement plan for debtors who seem completely and definitively insolvent violates arts. 10 and 11 of the Constitution (equality principle). The Court considers that the judge is not entitled to reject an application for the sole reason that the applicant has no resources. Total remission of debts is possible when integrated into a plan, by which the judge means supervisory measures such as guidance in budgetary management.

II.D.4.e)(5) Other Obligations during the Plan

In *Germany* and *Austria*, the payment plan period is also called "good behaviour period" (Wohlverhaltensperiode) as the debtor is obliged to seek employment and act for the benefit of his creditors. While such obligations are not emphasized in most other countries, the debtor may have some obligation to loyalty in other countries also.

A most difficult question is how the law should regulate the assets the debtor acquires during the plan, such as an inheritance etc. In *Denmark*, the debtor has usually no obligation to report such items. In *Germany*, half of the inheritance has to be distributed to

210 The law was amended to include this discharge provision in 1998; Loi 98-657 (29 July 1998).

the creditors. In *Finland*, all assets over a certain value (1,000 euros) have to be distributed to the creditors.

II.D.4.e)(6) Plan Modification

The *res judicata* effect of the plan is related to the possibilities of annulment, but its most controversial applications relate to the possibilities of modifying the plan once it has been accepted.

In *Austria* and *Germany* the plan is not fixed at all because it comprises all the debtor's income that could be garnished. When the debtor's income changes the payments to the creditors change.

In most other countries, the plans are in principle fixed, that is, they do not change as the debtor's income or expenses change, except in cases of hardship. For example, in *Denmark*, modification of the plan is rare.

Many laws allow modification of the plan if circumstances change. In *Sweden*, modification is possible but it is emphasized that the change in the circumstances has to be essential and unanticipated for there to be sufficient reason for modifying the plan.

According to the *Belgian* law, the plan can always be changed if the circumstances change. The debtor, the creditors or the debt mediator can ask the judge to change the plan. The procedure is very simple: just a letter to the judge, then the judge will decide a day to discuss it and will inform all parties, so they can present their arguments (Loi du 5 juillet 1998 relative au règlement collectif des dettes, art.1675/14). Also in *Luxembourg*, the plan can change if new circumstances constitute reasons for change. Since these laws are rather recent, there is no practical experience of the modification processes.

In *Finland*, however, the debtor is obliged to pay additional payment to the creditors during the plan if his income increases above a certain level (increase of 800 euros or more per year). The flexibility of the plan has turned out to be a major problem in Finland since debtors have difficulties understanding when they are obliged to make additional payments. Failure to pay additional payments is a breach of the payment plan and can lead to annulment.

II.D.4.f) Cost of Monitoring/Procedure

The administrative costs of the consumer insolvency procedure consist in principle of three types of costs: the court costs, costs for debtor representation and costs for plan drafting and plan administration. The allocation of these costs is complicated by contradictory considerations. Since the debtor's payment capacity is usually small, the economic interests involved are usually small.



While these are mass cases in district courts, some cases involve complex litigation concerning, for example, principles of insolvency law, civil law on securities, issues of matrimonial property etc. Debtors often need different kinds of social and financial counselling in addition to legal assistance. Individual creditors may have a small interest in an individual case but they have a legitimate concern that their collective interest is appropriately monitored. Thus, while there are pressures to keep costs down, there are several factors that tend to increase the costs.

It is a general principle in the European insolvency laws that the costs should not restrict access to discharge. Court fees for consumer insolvency are either abolished or fairly low (for privilege in Germany see subchapter II.D.4.c)).

Also many Member States have several policies which aim at providing the debtors with assistance at the filing stage. As will be discussed in chapter II.E, these services are organized by state or municipal authorities, different welfare and consumer organizations and municipal banks in the Netherlands. These services are usually free of charge or carry minimum payments. In many cases, they are operated with financial support from the state. Also, free legal aid is available in some countries, while in others it is thought that debt counselling services are sufficient in consumer insolvency matters.

There are different approaches to how the plans are drafted and administered. A distinction can be made between systems in which these tasks are vested in authorities or semi-official bodies and systems in which private bankruptcy or other practitioners are involved.

Especially in *Sweden*, plans are drafted by a state authority, Kronofogdemyndigheten, which is responsible for debt enforcement. In *France* and *Luxembourg* also these tasks are dealt with by the commissions for overindebtedness. An advantage of this arrangement is that the costs are borne by the body that handles the cases. Therefore, the issue of allocating costs among the parties involved does not arise in these countries.

In most other countries the plan drafting and administration is undertaken by private practitioners. In *Belgium* and the *Netherlands* the capacity to act as a trustee in consumer insolvency requires a prior authorization. In Belgium, these tasks are performed by debt mediators. The profession is restricted to lawyers, ministerial officers, attorneys and authorised public or private institutions (in practice, Centres Publics d'Aide Sociale and money advice organisations).

Private practitioners, both lawyers and financial practitioners, act as trustees in *Austria, Denmark, Finland, and Germany*. In Germany, the debtor and creditors may propose a person to act as a trustee and the court makes the nomination. The trustees are usually insolvency practitioners. In *Denmark*, practicing lawyers are appointed as trustees. In *Finland*, the trustees are usually private practitioners but also a bailiff or a deputy bailiff may be appointed as an administrator, although this is not common.

In some countries the employees of the same organizations that offer debt counselling and advice also act as trustees. In *Luxembourg*, the Ligue Luxembourgeoise de Prévention et d'Action Médico-Sociales (the Luxembourg League for Prevention and Medical and Social Action) offers a wide range of medical and social services to people who encounter social problems, including the management of the social and financial situation of people who have had recourse to the Overindebtedness Law. Both the Mediation Commission and the Juges de Paix have hitherto relied on the Service d'Accompagnement Social for the social follow-up of overindebted people.

In most countries the trustee fee is paid by the debtor. In *Denmark* the fee is paid by the state. If the debtor's resources are insufficient in *Belgium* the fee will be covered by a Fonds de Traitement du Surendettement, created by law and funded through an annual levy on a percentage of the sums outstanding under credit agreements. In *Finland*, the debtor's payments are used to pay for the trustee's fee during the first four months of the plan. If this is not enough, the rest will be covered by the state.

The trustee's fees are regulated in many countries. In *Belgium*, the scale of fees for mediators is set by the Royal Decree of 18 December 1998 establishing the rules and rates for setting fees, emoluments and charges of debt mediators. In *Austria*, the costs of the trustee in the probationary period are in accordance with § 204 KO. 4% of the first 22,000 euros of the amounts which are transferred to the trustee by assignment, 2% from the excess amount up to 100,000 euros and 1% of the amount going beyond it, at least however 10 euros monthly, in each case plus Value Added Tax. For the trustee in the bankruptcy proceedings there is a special rule in § 191 Exp. 1 KO providing a minimum of 750.00 euros for their activities. The fees are paid by retaining sums from the amounts which the trustee receives from the assignment.

In *Germany*, fees for trustee are 5% of the first 25,000 euros of the debtor's seizable earnings, other payments or other proceeds, 3% from the excess amount up to 50,000 euros, 1% of the amount going beyond 50,000 euros. The remuneration amounts



to at least 100 euros for each year of the trustee's activity (§ 14 Insolvenzrechtliche Vergütungsverordnung - InsVV).

In *Finland*, the fees depend on the number of debts: 1-4 debts 380 euros, 5-14 debts 480 euros and over 16 debts 670 euros plus taxes. The cost of copies and postage are added.

In *Denmark*, the size of the fee is decided by the bankruptcy court taking reasonable account primarily of the time spent by the trustee. In an ordinary case the starting point seems to be approximately 10,000 DKK (1,350 euros).

In the *Netherlands*, the size of the fee is decided by the bankruptcy court taking reasonable account primarily of the time spent by the trustee.

Table 24: Consumer Insolvency Law – Cost of Trustee

Member State	Pre court: Costs by	Court: Costs by	Trustee	Notes
Austria	debtor	debtor	insolvency practitioners	surety at filing
Belgium	debtor	debtor	mediators	foundation for costs; secondary
Denmark	-	state	-	lawyers fee by legal aid
Finland	state	debtor	practitioner	debt advice for pre-court trustees fee for 4 months in plan
France	cost free	cost free	commission	commissions perform the tasks
Germany	debtor	debtor	insolvency practitioners	
Great Britain				debt advice centers have a role in County Court Administration Orders
Greece	-	-	-	
Ireland	-	-	-	
Italy	-	-	-	
Luxembourg		state	medico-social services	
Netherlands	municipal banks	debtor	practitioners	
Portugal	-	-	-	
Spain	-	-	-	
Sweden	cost free (state)	cost free	enforcement agent	

II.E Debt Advice

Availability of professional and free or low-cost debt advice is a **key determinant in the prevention of overindebtedness and feasible economic rehabilitation**.

The preventive measures, including legal, financial (budgeting, financial education etc.) and social measures, can remain ineffective if debtors are not given the necessary advice and support in utilizing them.

Also the degree of sustainability of a consumer insolvency scheme is dependent on the debtor's opportunity to gain access to debt advice before, during and after his insolvency proceedings. The objective of "fresh start" is not necessarily achieved by the discharge of debt. The discharge represents only the economic solution to overindebtedness: the debtor has formally performed his financial commitments and other obligations during the proceed-

ings; his discharge illustrates the formal closing of the proceedings. Only the time after the insolvency proceedings will prove whether the debtor will regain his creditworthiness. Therefore, the debtor's economic rehabilitation carries out itself during a long-lasting process. The lasting effect of insolvency proceedings is recognizable when the debtor has regained access to financial and social resources as needed.

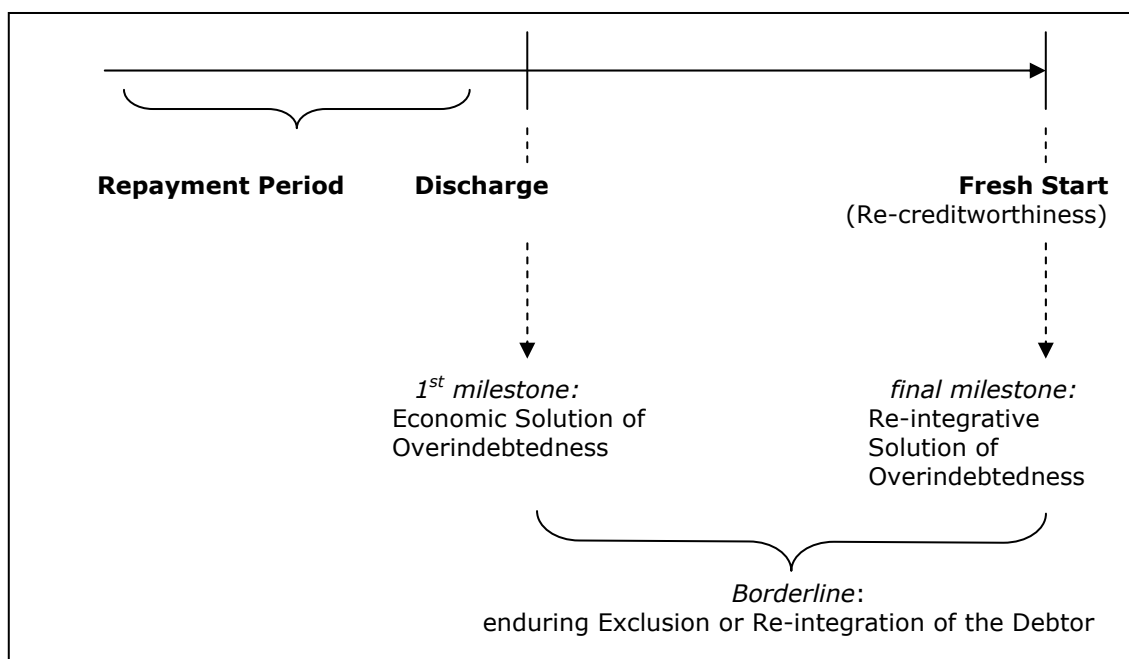


Figure 2: Process of Economic Rehabilitation

Different elements of support have to be involved in this process in order to promote the debtor's economic rehabilitation:

- debt adjustment
- social work
- insolvency procedure
- debt prevention

All elements require a considerable contribution of debt advice. In order to support not merely an economic solution to overindebtedness but to promote a re-integrative solution, debt advice should fulfil the following minimum standards:

Table 25: Core Elements of Debt Advice

Core Element	Brief Description / Examples
Budget analysis and budget advice	Analysing the monthly income and expenditure of the debtor's household (actual state). Advice as to how to manage the financial affairs.
Financial planning	Forecasting the future financial scope of action, especially the future financial burdens during the repayment period.
Debt settlement	Drafting and bargaining of a debt settlement with all the creditors.
Monitoring of legal claims	E.g.: Legitimacy of credit contracts, protection from execution, protection of debtor's income and assets.
Social work	Support in case of psychosocial problems as a consequence of overindebtedness; refreshment of self-curativeness; reference to other social services, if needed.
Mobilisation of social security	Mobilisation of social welfare benefits.
Supervision	Administrative support of the debtor with the fulfilment of his repayment plan.
Financial literacy	Imparting skills, understanding and social competence in order to voice problems with financial services and to make productive use of them.

Apart from these qualitative requirements, Member States should also offer a variety of debt advice that accompanies debtors during

the life cycle of their financial commitments and the process of their financial crises, that is to say, support and monitoring from the raising of credit (initiation phase) up to the stage of rehabilitation.

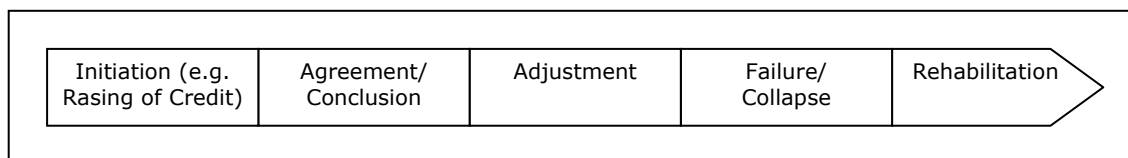


Figure 3: Chronological Starting Points for Financial Advisory Elements of Debt Advice

Otherwise the risk exists that “teachable moments”²¹¹ remain unused and that discharged debtors will be released into their “second lives” without the necessary assistance.

The afore-mentioned requirements set the benchmark for the following analysis as to whether and how EU Member States offer debt advice that supports the economic rehabilitation of overindebted consumers and the prevention of overindebtedness.

II.E.1 Debt Counselling

II.E.1.a) Developments since 1994 (General Survey)

Since the publication of the research study “Overindebtedness of consumers in the EC Member States: Facts and Search for Solutions”²¹² in 1994 (hereinafter referred to as *1994-Overindebtedness Study*) debt counselling services²¹³ have improved. Three findings of the former research study determined the characteristics of debt counselling services in the EU at that time:

- a limited offer of assistance for overindebted consumers in those Member States less familiar with the different forms of credit and its consequences (*Greece, Italy, Spain*);²¹⁴

211 Block-Lieb, S./Gross, K./Wiener, R.L.: cf. footnote 77, p 508

212 Huls, N., et al.: cf. footnote 1

213 This research study uses the expression “debt counselling” as a superior term. The study is aware of deviating understandings or practices of debt counselling in the Member States. The study bears in particular in mind that France will understand debt counselling in the sense of „gestion” which means in practice debt administration or debt mediation (for more details see answer to Item 76 in the French questionnaire, cf. Final Report, Part II - Annexes, III.C).

214 No Portuguese report was delivered in time; see Huls, N., et al.: cf. footnote 1, p 87

- a debate as to whether debt counselling should be incorporated within other social and publicly provided services or should be carried out by specialised agencies;²¹⁵
- a lack of comprehensive debt counselling services.²¹⁶

Although a gap between northern and southern Member States continues to exist, a trend reversal in the southern countries is identifiable. There is still a debate as to whether overindebtedness is an individual failure or a social phenomenon²¹⁷, but the extension of financial services and the uncertainty of income in these countries give rise to an increased awareness of overindebtedness and therefore to the demand for more specialised and independent debt counselling services.²¹⁸

For those “debt experienced”²¹⁹ countries that have reformed or incorporated a consumer insolvency proceedings²²⁰ since 1994 it is worth noting that the number of debt counselling agencies as well as the degree of their formalisation, centralisation and specialisation has increased:

- In *Germany* the number of debt counselling agencies increased from approximately 300 in 1989²²¹ to 1105²²² organisations in 2002; *Sweden* reported about 500 consumer counsellors in 1999²²³ compared to 238 counsellors in 1995²²⁴.
- The Insolvency Laws of some of these countries have defined new tasks for debt counselling agencies. Only those agencies that provide evidence about the required skills and experience are allowed to assume these tasks.²²⁵

215 L.c., p 87,88

216 L.c., p 87: Comprehensive debt counselling service is defined as “... aimed at assisting consumers with their financial problems needs to be an independent form of help and to be provided by persons operating within the guidelines of their profession. The service needs to take account of interests of the debtor as well as those of the creditor if it is to be effective.”

217 For the debate in Italy see for example: *Monti, D.*: Draft Project for Legislation – To deal with a Family’s Overindebtedness and the Appointment of a „Family Economic Consultant“, in: *Money Matters* 3/2001, p 5 (6)

218 For more details about the services in the Southern Member States see II.E.1.b)

219 *Huls, N., et al.*: cf. footnote 1, p 87

220 Belgium, France (Loi n 98-657 of July 29, 1998), Germany, Luxembourg

221 *Huls, N., et al.*: cf. footnote 1, p 89,90

222 See “Was mache ich mit meinen Schulden?”, Brochure of the Federal Ministry for Family, Seniors, Women and Youth, 9th edition, 2002

223 *Rydell, A.-M.*: Sweden – National Report, in: *Money Matters* 2/1999, p 4

224 *Näslund, H.*: The Swedish approach to budget and debt advice, in: *Money Matters* 2/1995, p 3

225 Austria, Belgium, Germany and Luxembourg

- The increasing complexity of debt settlement procedures²²⁶, particularly with regard to developing economically reasonable repayment plans and handling debt adjustments in accordance with the law, demands more professional skills. Several national debt counselling agencies are therefore considering the possibility of some sort of common professional profile and the possibility of networking among regional debt counselling agencies or networking with external experts.²²⁷
- The complexity of debt settlement procedures has also given rise to modifications with regard to the advisory approach. The function of debt counselling is changing from a social work approach to an economic social work approach.

II.E.1.b) Structure and Organisation of Debt Counselling Services

Debt counselling is in some way or other **regulated by law** in most of the Member States. Only *Denmark, Greece, Ireland, Portugal, Spain*, and the *United Kingdom* do not provide special legal provisions for such activities – respectively individual or special activities – of their debt counsellors.²²⁸

Table 26: Regulation of Debt Counselling

Member State	Is Debt Counselling regulated by Law?	Statutory Source
Austria	Yes	§ 12 Insolvenzrechtseinführungsgesetz
Belgium	Yes	The Communauté Flamande, Communauté Germanophone, the Region Wallone and the Region Bruxelles-Capitale regulate debt mediation services in own decrees (for more details see Annex to the Belgium Questionnaire).
Denmark	No	
Finland	Yes	Act of Economy and Debt Counselling 2000/713
France	Yes	L.321-1 Code de la Consommation defines which consultants and what kind of consulting services are prohibited.
Germany	Yes	Individual money advice responsibilities are regulated by: § 3, no. 9 Rechtsberatungsgesetz (Legal Advice Act) § 305, para.4 Insolvenzordnung (Insolvency Act) §§ 8, 17 Bundessozialhilfegesetz (Federal Social Security Act)
Great Britain	No	
Greece	No	
Ireland	No	
Italy	Yes	Art. 16 Disposizioni in materia di usura, l. 7 marzo 1996, n. 108, regulating "mediatori creditizi".

226 out-of-court and court procedures

227 **Luxembourg**: Cooperation agreement between "Service d'information et de conseil en matière de surendettement" and "Inter-Actions" implemented in 1997 (for more details see: *Schumacher, C.*: Debt counselling in Luxembourg, in: *Money Matters* 1/2000, p 13). **Finland**: The debt counselling network has spread since the introduction of the Debt Adjustment Act in 1993 (for more details see: *Aatola, L.*: Debt Counselling in Finland, in: *Money Matters* 1/1996, p 10). **Germany**: Debate on the introduction of a mandatory curriculum for debt counsellors.

228 Item 74 of the Questionnaire (cf. Final Report, Part II - Annexes, III.C)

Luxembourg	Yes	Loi du 8 decembre 2000 concernant "la prévention du surendettement et portant introduction d'une procédure de règlement collectif des dettes en cas de surendettement" (Titre II/Chapitre I "Le Service d'information et de conseil en matière de surendettement").
Netherlands	Yes	Consumer Bankruptcy Act (Wet schuldsanering natuurlijke personen)
Portugal	No	
Spain	No	
Sweden	Yes	Skulssaneringslag § 1 (Law on Social Services)

Those Member States that provide special legal provisions have chosen different **statutory sources**:

- In *Austria, Germany, Luxembourg* and the *Netherlands* a close interrelationship between the introduction of the respective consumer insolvency proceedings and the introduction of regulations for debt counselling can be observed. In these countries the regulations for debt counselling form an integral part of the Insolvency laws.
- *Finland* as well as the *Belgian* communities and regions have initiated separate laws on debt counselling.
- *Italy*²²⁹ regulates "Mediatori creditizi" within the law on usury. That is connected with the fact that "Mediatori creditizi" act on behalf of creditors in order to promote their lending business.²³⁰
- With the "Code de la Consommation" *France* has chosen a more general framework for the regulation on what kind of debt counselling services are prohibited.
- Besides the above mentioned, *German* regulation for insolvency advice, arts. 8, 17 of the German Federal Social Security Act provide the general legal basis for money and other advice on behalf of overindebted households entitled to social welfare. *Sweden*, with its Social Services Law has chosen a similar statutory source.

The laws specify: either²³¹

- debt counselling as **public responsibility** (*Sweden*) or **statutory obligation** that free debt counselling is available (*Finland*);
- a **licencing system** for debt counselling agencies or debt counsellors; this is the case for *Austria, Belgium, Germany*²³² and *Luxembourg*;

²²⁹ The debt counselling service of consumer organisations or social welfare organisations (e.g. Debt Advice Centres South Tirol and Bozen) is not regulated by law.

²³⁰ For more details see II.E.1.c)

²³¹ Item 75 and Item 76 of the Questionnaire (cf. Final Report, Part II - Annexes, III.C)

²³² art. 305, para.1 no.1 Insolvency Act

- **personal requirements** of advisors (*Finland, Germany*²³³); or
- the **fields of permissible activities** (the *Netherlands*) or **prohibited activities** (*France*).

In order to obtain a licence or to comply with the regulations the afore-mentioned Member States – except *France* – established the following rules:²³⁴

- non profit organisation
- service free of charge
- minimum of personal and technical resources
- fully qualified counsellors or – at least – special training in counselling
- proof of quality management

The *French* regulation specifies that any chargeable counselling service is prohibited if the consalter could obtain this service free of charge from a judge or simply by asking his creditor.

Different institutions are responsible for supervising compliance with these formalities or regulations: the national debt counselling agencies (e.g. *Luxembourg*²³⁵), local governments and (state) consumer agencies (e.g. *Finland*), Ministry of Justice (e.g. *Austria*) or the courts (e.g. *Germany*).²³⁶

Irrespective of whether debt counselling is regulated by law, the **main agencies** providing debt counselling are:²³⁷

233 The implementing statutes of the German Länder specify the personal requirements.

234 The following rules are not followed in the same way by the relevant Member States.

235 This is even the case in Ireland which has no special regulation for debt counselling. But the network of Money Advice and Budgeting Services (MABS), being comparable with a national debt counselling agency, verifies the activities in order to satisfy the funder (Department of Social and Family Affairs).

236 The questionnaire did not ask explicitly who is in charge of supervision. Therefore, the listing of institutions may be incomplete.

237 Item 77 of the Questionnaire ((cf. Final Report, Part II - Annexes, III.C)

Table 27: The Main Providers of Debt Counselling in the EU Member States

Member State	Main Provider(s)
Austria	Independent, non profit-making organisations
Belgium	Centres publics d'Aide Sociale; Non profit organisations
Denmark	Consumer organisations
Finland	Municipalities
France	Consumer associations (sporadic); social workers; non profit-making organisations (e.g. Debtors Anonymous, Society of St Vincent de Paul) <i>(Attention is drawn to the fact that the Overindebtedness Committees are not regarded as debt counselling agencies.)</i>
Germany	Local authorities (e.g. social welfare authorities, youth welfare departments); Caritas / Diakonisches Werk; Deutscher Paritätischer Wohlfahrtsverband; German Red Cross; Workers' welfare; Consumer organisations
Great Britain	Consumer Credit Counselling Service; National Debtline; Citizens Advice Bureau with its local branches; Commercial debt management services
Greece	E.K.PI.ZO Consumer Association "Quality of Life"
Ireland	Money Advice and Budgeting Services (MABS) with its local branches
Italy	Local branches of Anti-usury foundations; Consumer organisations (e.g. Adiconsum, Codacons, Adusbef, Adoc, Aduc); "Mediatori creditizi"
Luxembourg	Service d'Information et de Conseil en Matière de Surendettement (administered by the Ligue Luxembourgeoise de Prévention et d'Action Médico-Sociales); Service d'Information et de Conseil en Matière de Surendettement (administered by Inter-Actions)
Netherlands	Municipal Credit Banks; Social services; Private organisations; Attorneys; NIBUD (National organisation of debt advice)
Portugal	DECO (consumer protection organisation); CIAC (municipal information centres for consumers)
Spain	Agencies comparable with financial intermediary services
Sweden	Municipalities

The afore-mentioned providers can be characterised as follows:

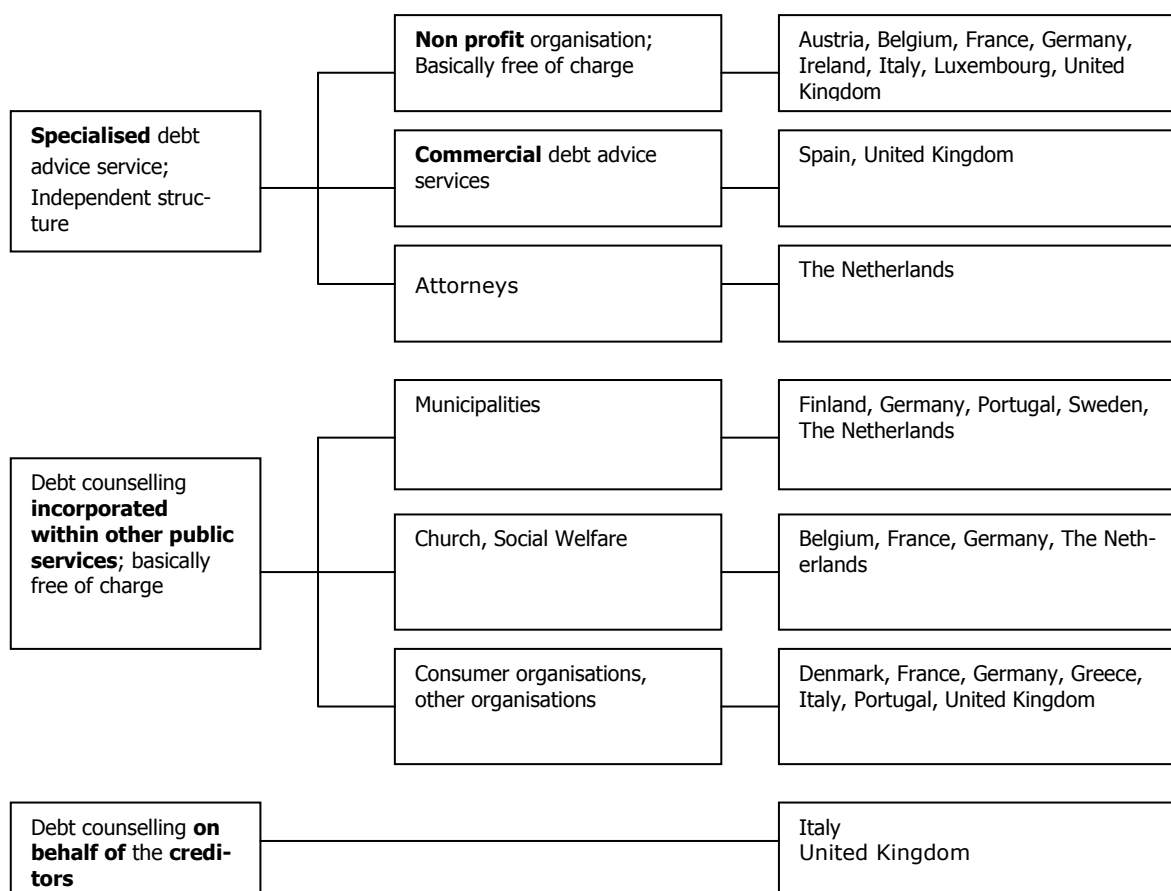


Figure 4: Typology of the Main Providers of Debt Counselling in the EU-Member States

The development status of debt counselling providers in the Member States has changed slightly but not significantly since the *1994-Overindebtedness Study*. Even though debt counselling in *Ireland* can no longer be described as “under-developed”²³⁸ in view of the work of the Money Advice and Budgeting Services (MABS), a scarcity of specialised and independent agencies is still obvious in most of the southern Member States, especially in *Greece*. Although the financial service market in *Southern Europe* expanded in the last decade and with it the problems of overindebtedness, the required quantity and diversification of debt counselling services or the development of a debt counselling network lags behind expectations.

238 Huls, N., et al.: cf. footnote 1, p 93

II.E.1.c) Advisory Approach

Debt counselling developed traditionally from social work or general consumer counselling. This applies in particular to the “debt experienced”²³⁹ Member States, which understand overindebtedness as a social problem and therefore the struggle against poverty as a public task. Debt counsellors in these countries were therefore originally familiar with the social aspects of overindebtedness and cared primarily for their clients’ social security.²⁴⁰ Hence the *1994-Overindebtedness Study*²⁴¹ claimed that debt counsellors should have more

- profound knowledge of the financial and legal aspects of overindebtedness,
- and insight into the functioning of financial markets.

In recent years debt counselling seems to be moving away from its traditional social work background, although debt counselling remains incorporated in the organisational structure of social welfare or consumer organisations, municipalities, etc. The following table outlines the main debt advice services that are provided in the Member States nowadays.²⁴² Most frequently budget analysis, budget advice and debt settlement was designated.

Table 28: Main Debt Advice Services

Countries	Budget analysis & advice	Financial Planning	Debt settlement	Legal advice	Social work	Social security	Supervision	Prevention, Financial literacy
Austria	X		X		X			X
Belgium	X		X					
Denmark	X							
Finland	X	X	X	X				X
France	X				X			
Germany	X		X	X	X	X		X
Great Britain	X		X				X	
Greece			X	X				
Ireland	X	X	X				X	X
Italy	X	X		X				
Luxembourg	X		X					
Netherlands	X	X	X		X		X	
Portugal	X		X					
Spain			X				X	
Sweden	X		X					
TOTAL	15	4	12	4	4	1	4	4

239 Huls, N., et al.: cf. footnote 1, p 87

240 L.c., p 260

241 L.c., p 258 ff

242 Item 78 of the questionnaire (cf. Final Report, Part II - Annexes, III.C)

According to this table the main focus of debt counselling has shifted from a social work perspective towards an economic social work perspective. Does this development satisfy the claims that the *1994-Overindebtedness Study* made? Do the advisors now have the required profound social, legal and economic know how? If one assigns the main debt advice services available today to the process of financial crises (see the following Figure), it is striking that budget analysis, budget advice and debt settlement refer only to the fourth phase "Failure/Collapse". The assistance during the remaining phases seems to be incomplete.

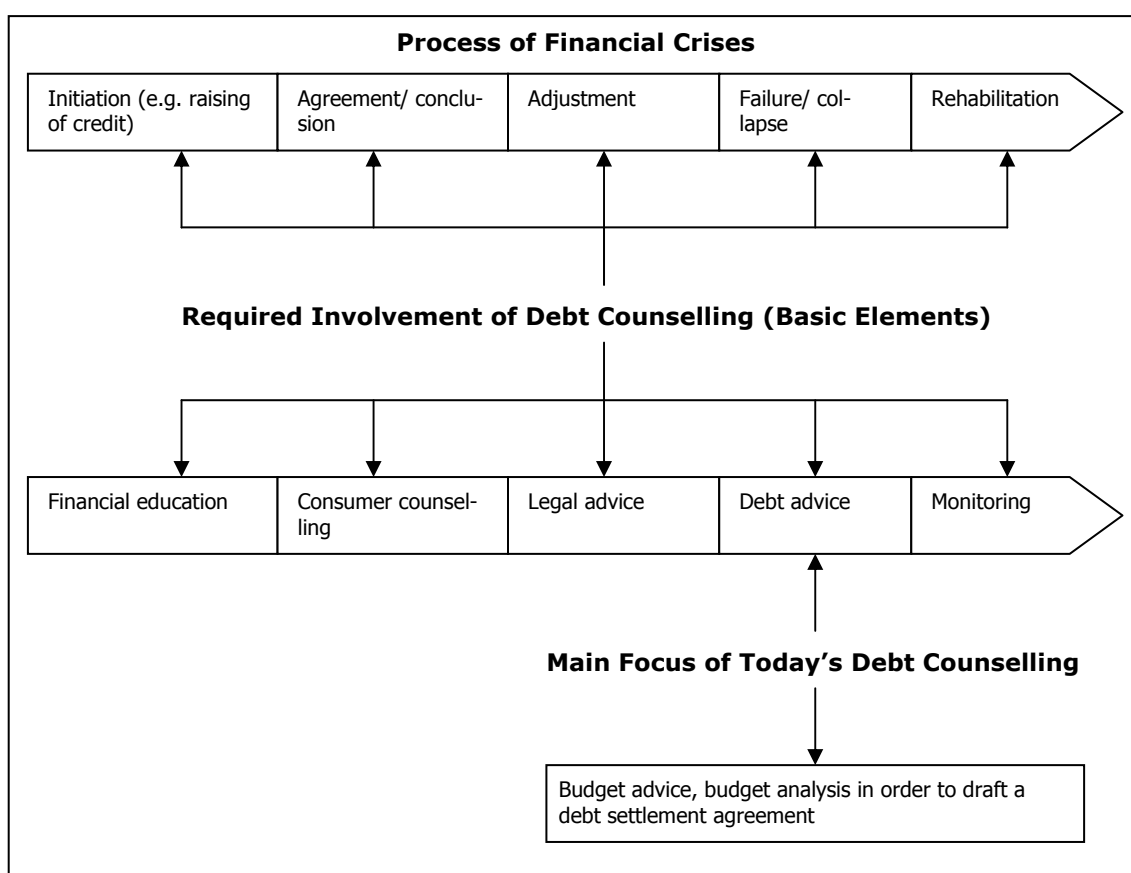


Figure 5: Correlation Debt Counselling versus Process of Financial Crises

The "legalization" of consumer insolvency, in particular the incorporation of consumer insolvency proceedings since the nineties, prompts a concentration on drafting, bargaining and negotiating debt settlements. Social workers had to become experts in insolvency law and related procedural law. The trend that debt settlement absorbs most of the counsellors' energies will continue in view of the increasing number of consumer bankruptcies in

Europe.²⁴³ Although the *1994-Overindebtedness Study* correctly declared that the advisors should have more specialised knowledge, the new direction of debt counselling contains two alarming risks:

- Debt counselling may degenerate into pure debt administration. The problems with overindebtedness do not only have to be administered, but must also be mastered in their structure. It has already been observed that advisers neglect to verify the legality of single claims because they know that a bankruptcy procedure will be opened. Thus the consumers' concerns are reduced to obtain a debt relief in accordance with the relevant model of the law.
- Debt counsellors neglect their core skill, namely social courtesy.

II.E.2 Entitlement to Free Legal Advice

Legal advice is one core elements in debt advice in promoting a re-integrative solution for overindebtedness.²⁴⁴ The debtor is already dependent on legal advice if the first interferences occur in his contractual relationships with his creditors. This legal advice includes for example

- the debtors' information about their (contractual) rights and obligations,
- the verification of the legitimacy of the contract terms, and
- the filing of claims or objections.

Therefore access to legal advice has to be ensured before the debtors' failure or collapse.²⁴⁵

Most of the EU Member States provide some sort of legal assistance to low income citizens that is free of charge or at a reduced rate.²⁴⁶ The legal advice typically deals with civil, family, divorce, maintenance and inheritance matters and does not cover debt adjustment, as this kind of service in particular is provided by specialised debt counselling services.²⁴⁷

243 Insolvenzen in Europa, in: Creditreform-Magazin 3/2003, p 51/52 (http://www.creditreform-magazin.de/page/hefte/cr_03_03_pdf/s_48_52.pdf)

244 see Table 25: Core Elements of Debt Advice ("Monitoring of legal claims")

245 see **Fehler! Verweisquelle konnte nicht gefunden werden.**

246 Item 79 of the questionnaire (cf. Final Report, Part II - Annexes, III.C)

247 see II.E.1

Table 29: Access to Legal Assistance in the EU Member States

Member State	Debtors entitled to Legal Aid	Statutory source	Fees	Preconditions
Austria	Yes	Not specified	Not specified	Not specified
Belgium	Yes	Not specified	Not specified	Dependent on predefined income limits
Denmark	Yes	Not specified	Reduced fee	Not specified
Finland	Yes	Legal Aid Act		Need for a lawyer and his specialised knowledge
France	Yes	Not specified	Not specified	Dependent on predefined income limits
Germany	Yes	Beratungshilfegesetz; Code of Civil Procedure; Insolvency Act; Federal Social Security Act	Free of charge, or reduced fee	Dependent on predefined income limits; Need for a lawyer and his specialised knowledge; the procedure must offer a reasonable prospect of success
Great Britain	Yes	Not specified	Not specified	
Greece	Yes	Code of Civil Procedure	Free of charge	Dependent on predefined income limits
Ireland	Yes	Civil Legal Aid Act (1995)	Reduced fee or minimum contribution	Dependent on predefined income limits; The procedure must offer a reasonable prospect of success; Certain types of disputes are not covered (concerning properties, conveyancing etc.)
Italy	Yes	"gratuito patrocinio", d.p.r. 30.5.2002, n. 115, artt. 74 ff.	Free of charge	Dependent on predefined income limits; Need for legal relief
Luxembourg	Yes	Law of 18.8.1995 (judicial assistance)	Not specified	Not specified
Netherlands	No			
Portugal	Yes	Law n. 30-E/2000 of 20.12.2000	Total or partial exemption from court and lawyers' fees	Dependent on predefined income limits
Spain	No			
Sweden	Yes	Not specified	Not specified	Not specified

The debtors' entitlement to legal assistance follows from the principle that all citizens have an equal opportunity of access to justice especially to jurisdiction. Free legal advice²⁴⁸ is therefore typically limited to the debtors' legal representation in civil court procedures ("legal aid"). The prevalent preconditions are that the facts of the case need the verification of a legal expert and that the court procedure offers a reasonable prospect of success. It is less common for debtors to use free legal assistance in order to negotiate adjustments to contracts or other forms of private settlements. Only *Germany*, *Greece* and *Ireland* indicated that low income citizens may have access to free out-of-court legal assistance.²⁴⁹

²⁴⁸ or legal advice at a reduced rate

²⁴⁹ **Germany:** The local court grants a low-income citizen a certificate of entitlement which the citizen can use to instruct a lawyer of his choice. The citizen has to pay the lawyer a fee of 10 Euro unless he is released from this obligation. The remaining costs are met by the state. **Greece:** The local Justice of

In most of the Member States, local courts are in charge of granting legal aid, except in *Ireland* where local “Law Centres” are responsible.

There are no official bulletins for each country on the practical significance of legal aid provisions. *Greece* for example, indicated that its relevant provisions (Articles 194-204 of the Greek Code of Civil Procedure) are still exercised reluctantly. *France* warns that overindebted citizens may be excluded from free legal assistance. If a French citizen is overindebted but exceeds the predefined income limits anyhow, he is not entitled to free legal advice. *Germany* has a well-established practice of granting free legal aid in civil court procedures. But in consumer bankruptcy proceedings the current practice is to avoid assigning a lawyer.

The access of overindebted citizens to free legal aid seems to be partial. Assistance is in general limited to the afore-mentioned litigation which does not include consumer bankruptcy proceedings. The provision of free out-of-court legal support is insufficient, and particularly the debt counselling agencies tend towards a restriction of legal support.²⁵⁰

II.E.3 Financial Education

Debt counselling and legal advice are aimed at coping with the acute financial crisis of a debtor. The consultation process therefore starts in principle only directly before the debtor files for consumer insolvency proceedings. The aim of financial education is not case-related crisis management, but to give consumers – regardless of their financial circumstances – the opportunity to

- develop numeracy, literacy, and information technology skills in the context of personal finance;
- develop an understanding of the nature and use of money in its various forms, including credit and debt, savings and investment;
- learn how to access, interpret, question, and evaluate financial information and advice;
- learn about the consequences of financial decisions and about consumer rights and responsibilities; and
- learn how to weigh up risks and benefits in order to choose appropriate solutions to particular financial needs.

the Peace may grant legal aid for out of court disputes. **Ireland:** <http://www.legalaidboard.ie>

250 See II.E.1.c) and Table 28: Main Debt Advice Services



In addition, financially literate and competent consumers can be a force for changing and shaping financial markets, encouraging competition, leading to innovation, better quality and better value for money.²⁵¹

Financial literacy as an autonomous discipline has become the focus of public attention only in recent years. In particular, research in the Anglo-Saxon and American area conducted on social and financial exclusion of consumers, uncovers the problems of financially illiterate consumers and the need for group-related financial education programmes.²⁵² Meantime, most of the Member States have welcomed the introduction of financial education in school curricula²⁵³ and programmes for vulnerable individuals and other adults, but this is predominantly at the development stage (apart from *Great Britain* and – with some reservations – the *Scandinavian* countries). Research on financial exclusion reveals that we still know little about the consumers' needs for financial education and the levels of financial literacy across the population of Member States. Until now, there exists neither a common definition of financial literacy nor an agreement on how to measure consumers' financial skills and capabilities. So far there is only an agreement over the fact that financial education must begin at an early age and continue throughout life. The uncertainty about an agreed definition might cause erroneous evaluations of simple consumer information programmes as financial education programmes. Therefore, all the financial literacy approaches, concepts, programmes or activities, which are identified within the scope of this study (for more details see the following table) must be considered with the reservation that a common definition of financial literacy and financial education contents is still missing.

No financial literacy approaches, concepts or programmes could be identified for *Austria*, *Greece*, *Portugal*, and *Spain* which went be-

251 *Financial Services Authority (ed): Consumer Education: A Strategy for promoting Public Understanding of the Financial System*; London: Financial Services Authority 1999

252 For example: *Kempson, E./Whyley, C./Caskey, J./Collard, S.: In or Out? Financial Exclusion: A Literature and Research Review*, London: Financial Services Authority 2000; *Sinclair, S.P.: Financial Exclusion: An Introductory Survey*, Glasgow, Centre for Research into Socially Inclusive Services 2001

253 That is also related to the fact that the European Union included „consumer education“ in the general objective of consumer protection (art. 153 of the Treaty of Amsterdam 1997). Consumer education thus becomes a right for the citizens and an objective to be fulfilled jointly by the European Union and the Member States. See also the Resolution adopted by the European Council of Ministers for Education on Consumer Education in Primary and Secondary Schools (1986): „The competent authorities in the Member States should ensure the gradual introduction of consumer education into school curricula at primary and secondary level so that consumer education is systematically provided throughout the period of compulsory education.“

yond case-related budget analysis or general preventive consumer information (see Table 30). In the other countries different measures and activities exist. These can be assigned to the following actors:

- Measures taken by national public authorities
- Action taken by national consumer organisations and comparable not-for-profit organisations
- Financial education within the national educational system
- Activities of the financial industry
- Media activities

All measures and activities can be summarized as follows:

Table 30: Financial Education in the EU Member States

Member State	Service provided	Details	Provider	Pros and Cons
Austria	no special service provided			
Belgium	Écoles de Consommateurs	Different workshops dealing with subjects as budgeting, insurance, borrowing, bank documents, postal sales, payment methods, credit cards. Target group: "Vulnerable" citizens are given priority.	Since March 2001 the Walloon Minister for Social Affairs has allowed and funded approximately 105 applications to form an "École de Consommateurs". They are run by the "Centres Publics d'Aide Sociale" and other organisations (e.g. local social services, education agencies, youth centres).	Con: Sessions are mostly held during the day so that they could only be attended by part-time workers or unemployed.
	School subject "Consumer protection"	Course programme of the academic year 2001/02 within the schools of the French Community. Course design: analysis of contracts, economic structures of indebtedness, acting as consumer etc.	Schools within the French Community	
	Educational material (including games) for pupils	(not specified)	Primary schools in the Luxembourg Province.	
	Training courses and educational material	Organisation of training days for teachers. Content of the training: payment systems, consumer credit, stock exchange, e-commerce. Handouts for the public on banking profession and methods of payment.	Association Belge des Banques	

	Self-help groups as "Group Solidarité Budget"	Different consumer-related topics are developed in the course of each meeting (once a month). Group members have created the theatre company "Les Fauchés comme les blés" with their play "Le banc" about their self-experienced problems of daily social discrimination (roadshow including a subsequent discussion between actors and audience).	"Bâtissons notre Avenir" (since 1996 licenced as money advice service by the Walloon Region and funded by the Walloon Ministry for Social Action)	Pro: longstanding participants talk regularly about their past, their progress, and develop new approaches to consuming and crisis management. Con: open only for those using the money advice service of "Bâtissons notre Avenir".
	Leaflets on overindebtedness, courses in family budgeting, public library (infothèque)		Consumer Protection Centre of East Belgium	
	Television programmes as "Au nom de la loi", "Autant savoir", "Cartes sur table", "Questions d'argent".		Various broadcasting stations	
Denmark	Consumer education in schools; training of teachers	Personal finance as one element of consumer education (besides consumers' rights and obligations, commercial persuasion, health, environment etc.)	Established by the "Nordic Network for Consumer Education" within the framework of the Nordic Council of Ministers (Consumer Sector)	
	Information materials on various consumer issues in order to promote knowledgeable consumers		Danish Consumer Council (Forbrugerradet); Liberal Association of adult education (LOF)	
Finland	The Act of Economy and Debt counselling mentions "Financial education" for overindebted citizens as one objective.	(not specified)	Municipalities	
	q.v. the comments on Denmark and Sweden			
France	Leaflets, magazines, online information addressing financial service issues		Ministry of Economy and Finance; Caisses d'allocations familiales (CAF); INC; ANIL; various consumer organisations (e.g. ADEIC, AFOC, CLCV, CSF)	
	Family budgeting and related issues as (inter-disciplinary) school subject; teacher training		Circular of 17 December 1990 by the Ministry of Education	Con: no statistical research has been carried out
	Information/booklets addressing consumer credit, payment methods		Association Française des Sociétés Financières (ASF) and Fédération Bancaire Française (FBF) in cooperation with consumer organisations	
Germany	Leaflets, teaching material for pupils/young adults, group learning sessions for overindebted citizens, courses in family budgeting		local (non profit) debt counselling agencies and consumer organisations	Con: the topic of financial services is neglected.

	Non-regular learning units as "How to cope with money", that are incorporated in school subjects such as politics, social study or economy.		Local schools	Con: Financial education is not an integral part of the school curricula.
	Educational material for schools		Savings Banks, private banks	Con: The material ignores consumer rights and overindebtedness of private households.
	Local pilot schemes since 2002: "Financial Literacy at Hamburg Schools", "Financial Literacy in debt counselling agencies of North-Rhine-Westphalia", "Financial literacy within regional television programmes"		Institut für Finanzdienstleistungen, funded by the Federal Ministry for Family, Seniors, Women and Youth	Evaluation study (forthcoming within 2003)
Great Britain	"Personal Finance" as non-statutory part of the school curriculum in England (primary and secondary schools) (since September 2000)	Personal Finance topics are: Different forms of money, importance of keeping financial records, borrowing money (primary schools); consumers' rights and responsibilities, payment methods, budgeting, how to interpret bank statements (secondary schools). The financial topics are taught within other lessons (e.g. maths, PSHE, ICT, business studies, religious studies, english, history/politics, geography).	Other UK countries intend similar recommendations.	Cons: little research evidence on the extent, content or effectiveness of this teaching; low frequency of the teaching
	Money & credit management, budgeting for (potential) students		Student welfare offices, universities	
	Financial understanding and awareness	Target groups: children and adults	Government agencies, not-for-profit organisations as Personal Finance Education Group, Scottish Centre for Financial Education, Financial Services Authority, National Citizens' Advice Bureaux, Basic Skills agency, National Institute of Adult Continuing Education, Adult Financial Literacy Group Department of Trade and Industry, Department for Education and Skills provide resources for the teaching of financial education	
	Financial education provided by the financial industry	Development of teaching materials for use in schools. Running of school banks. Funding of initiatives (e.g. Sheffield Education Action Zone, HSBC's Education Trust)		

Greece	No special service provided			
Ireland	Community Education programme	The programme (including course material) consists of 6 to 8 sessions (lasting two hours each) and covers aspects of money management and credit use. Networking with other local experts, authorities, institutions and services is intended. Target group: low-income families	Local Branches of Money Advice and Budgeting Services (MABS), funded by the Department of Social, Community and Family Affairs	
Italy	Family budgeting; transfer of knowledge as to how to identify and to avoid usury practices		local anti-usury foundations and other local governmental bodies	
	Self-help material, publications	Dealing with topics as "Mortgage loans", "How to avoid overindebtedness", "How to choose your credit card"	Adiconsum and Altro-consumo	
Luxembourg	Family Budgeting		Service d'Accompagnement Social	
Netherlands	information materials (print, online, software etc.) on various financial issues; courses		Consumentenbond NIBUD	
Portugal	No special service provided			
Spain	No special service provided			
Sweden	Consumer education in schools; training of teachers	Personal finance as one element of consumer education (besides consumers' rights and obligations, commercial persuasion, health, environment etc.)	Established by the "Nordic Network for Consumer Education" within the framework of the Nordic Council of Ministers (Consumer Sector)	
	Information materials on various consumer issues in order to promote knowledgeable consumers		The Swedish Consumer Agency (Konsumentverket)	

The measures taken by national **public authorities** concentrate on the funding of educational projects (e.g. *Belgium*) or organisations that provide financial education in some respect (e.g. *France, Great Britain, Ireland*). In individual cases, the measures consist in legislative actions (e.g. *Finland, France*).

National **consumer organisations** and **debt counselling agencies** provide in particular information and teaching material (print, online, videos, games) on different issues of financial education. Some agencies provide workshops, group information events or school courses. However, all these activities are not based upon a co-ordinated financial education agenda and are therefore not incorporated into their everyday business. *Great Britain* – and with some reservations the *Scandinavian* countries – is an exception and has understood the necessity of an educational concept; thus

a substantial number of money advice and consumer organisations are engaged in this process.

This also applies - with restrictions - to financial education in **schools**. "Personal Finance" has become part of *UK* and *Scandinavian* school curricula although the frequency of teaching differs. Furthermore, financial education as major subject is only at the development stage (e.g. *Belgium, Germany*). However, contiguous learning units in the context of other subjects are common (e.g. Mathematics, Economics, Social Studies) although these are not always mandatory. Although it is recognised that financial education must begin at an early age, there is little evidence for an overall teaching concept of financial education in the national curricula.

The activities of the **financial industry** are quite numerous. But the prior objective is not to inform consumers about product risks and consumer rights but rather to promote a non-critical public understanding of the existing financial system and its present products.

Most **media** activities are not addressed to vulnerable citizens but concentrate on the needs of the "middle class".

As yet, there are hardly any national learning objectives and standards nor any means to measure levels of financial literacy across the population as a whole. It is too early to assess the impact of existing programmes and projects.

II.E.4 Conclusions

The research on debt advice comes to the following conclusions:

- In *Great Britain, Scandinavia, and Continental Europe* the degree of specialisation and professionalism in debt counselling continues to increase. That is recognized by the fact that the advisers are taking an economic social work approach.
- However, this specialization is limited to Insolvency Law. There is a noticeable trend of debt advisers evolving into legal advisers within the scope of Bankruptcy/Insolvency Law. Since the personnel resources of debt agencies are still scarce, this concentration can tie up too much capacity, so that too little time remains for social and preventive work.
- In the same countries, financial education of consumers developed as a special preventive measure. An unambiguous definition of financial literacy is needed in order to further such promising approaches.

- The provision of independent and specialised debt counselling is insufficient in the southern Member States.
- The provision of free or low cost out-of-court legal support is fragmentary in all Member States.
- At the same time, all the afore-mentioned inadequacies have a negative impact on the quality of cross-border debt advice.

So far in practice, two main starting points for debt advice – initiation phase and phase of failure/collapse – are used by altogether five starting points (see the following Figure).

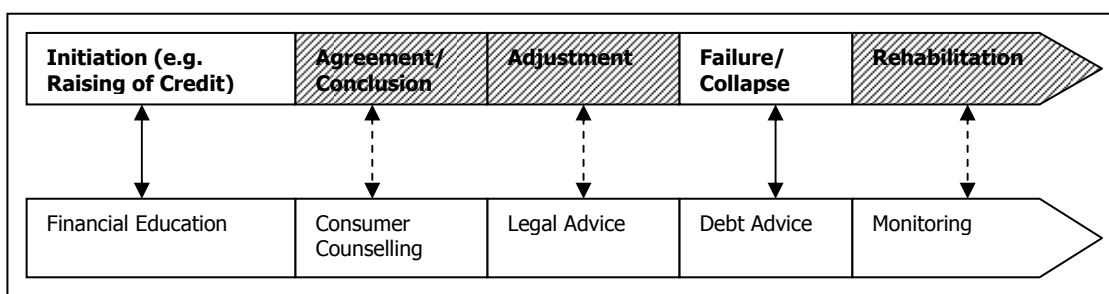


Figure 6: Debt Advice Practice

The gaps must be closed (see the hatched space in **Fehler! Verweisquelle konnte nicht gefunden werden.**) in order to improve the prevention of overindebtedness and feasible economic rehabilitation.

III Findings and Recommendations

III.A Consumer Credit Legislation

III.A.1 Findings

All Member States have basically incorporated the regulations of the Consumer Credit Directive in its present form. As to its effectiveness, it has to be kept in mind that very different systems of credit extension and credit supervision exist. While most countries have a bank monopoly in consumer credit, the *UK*, *Ireland* and, to some extent also, *Belgium* have other suppliers which may be rather small and difficult to control. This is partly also true for instalment purchase credit in rural areas which is by definition a by-activity of retailers and not of banks. In the other countries, the strict bank administrative bank supervision gives quite effective controls. If in these countries the Directive is not effective, it is because systematic misinterpretations or sophisticated products to circumvent its prescription (such as linked credit products with investment, insurance or payment services in particular) have been marketed. In those areas of small credit suppliers the lack of

effectiveness lies more with ignorance or deviant behaviour of short term suppliers which are difficult to control.

A new European tendency towards integrated financial services authorities covering all kind of financial services irrespective of the question who extends these products will gradually replace the old system of banking supervision and may help to cure these problems of a development "à deux vitesses".

While the actual Directive is mainly focussed on consumer choice and rational decisions and less inclined with problems of overindebtedness (which will significantly change if the Proposal for a new Directive will come into force), those rules concerning the prevention of overindebtedness and strategies to cope with its manifestations are mainly national.

In this respect there are Member States with strong protective rules like in this order *Belgium, France, Germany, the Netherlands and Luxembourg*. The *Southern* European countries and to some extent also *Austria* have little specialised rules concerning overindebtedness in consumer credit but like *Spain* and *Greece* have some old rules of debtors' protection especially in non-bank credit. Somehow in between are the *Scandinavian* countries with little strict rules but procedures to cope with these problems. The *UK*-approach is instead focussed on information, rational choice but there are presently intensive discussions to change this. *Ireland* has at least some special protective regulations concerning small suppliers.

The first group is especially characterised by modern interest rate ceilings which in different ways under different forms of supervision cap interest rates according to market rates for contractual as well as default interest rates. Instead of the traditional idea of usury as exploitation they assume that high interest rates reflect market failures. These countries provide also strict rules for early termination and especially the rules applying to default. Among those capped default rates, priority of capital amortisation for payments in default and restrictions on anatocism as well as restrictions to recover the cost of debt collection from the debtor seem to be the most effective way to take away any incentive for creditors to turn credit contracts into default relations.

Their informational consumer protection laws are related directly to the prevention of overindebtedness. They provide information on present and future liquidity (amortisation tables or total amount of credit) instead of mere prices for market comparison. This focus is the relation between assumed consumer income and future instalments while the other countries follow the Directive's ap-

proach to give price information, which make the comparison of products on the market easier. *France* has also a quite effective system of preliminary binding offers which give consumers a chance to seek advice while the right to withdraw in other countries is often compromised by the fact that the consumer already received the capital and cannot return it in order to make the withdrawal effective. As far as additional costs are concerned, the mentioned group provides restrictions on all kind of additional fees like especially broker and insurance fees and limits the way variable rate are defined and refinancing can be done.

In *Scandinavia*, there are a number of incentives to continue and adapt credit contracts with consumers in default. They top in some respect the approaches of the first group to restrict the termination of credit contracts. Instead of automatic acceleration clauses justified reasons for early termination have to be put forward and communicated i.e. a minimum of outstanding debt by size and time and the enumeration of justifications. They also oblige suppliers to mediate or at least introduce a waiting time giving debtors the chance to continue the old contract by paying the outstanding arrears even after cancellation.

All these rules have to be seen in light of the ruling market culture in these countries which is influenced by ethics of suppliers, the strength of (subsidised) consumer organisations, the existence of additional public consumer protection mechanisms like the ombudsman or mediators and a general culture of social care for the poor. There are especially differences between a more administrative approach in *France* and more judicial approaches in *Germany* and the *Scandinavian* countries.

III.A.2 Principles: Information and Income Protection

A model of a social credit contract to guide the interpretation of individual credit agreements could be based on the following principles:²⁵⁴

- Consumers should have a fair opportunity of access to all available services and products, to life-line accounts and protection against all discrimination based on the source or the amount of income.
- Consumers should obtain an accurate picture of the costs and consequences of a loan. The disclosure of the cost of borrowing should be complete, exhaustive and correct. It should

²⁵⁴ The principles are elaborated in: *Reifner, U.*: Principles of Consumer Protection in Financial Services (paper given at the 1st Inter-American Conference on Consumer Law Gramado, Rio Grande do Sul State, Brazil 8 - 11 March 1998; the paper is available at iff@iff-hamburg.de)

meet fully the evidentiary and warning functions of formalities and provide details of future payments in order to give the necessary information on liquidity.

- Consumers should be obliged to reflect on a credit commitment through the provision for preliminary offers and cooling-off periods as well as independent advice covering the product and its consequences.
- Debtors' social life-line must be protected. Creditors must respect minimum income and the double the average interest rate should be the limit of rates (usury).²⁵⁵
- Creditors should not profit from default but encourage credit adjustments through limitations on default interest. Repayment of debts must always be possible free of charge and should reduce the interest bearing capital first. There should be no extra profit from refinancing.
- Consumers should be supported in the productive investment of the loan. No interest should be taken if no effective use of credit is possible and interest pyramiding should be prohibited.
- The sale of linked products should be carefully monitored for the circumvention of credit protection rules.

These principles have to be implemented in two sets of regulations: consumer information and income protection in credit contracts.

III.A.2.a) Informational Consumer Protection

There is still little conscious legislation in contract law on the prevention of overindebtedness through improved information rights. However, many of these rights, as for example the extensive legislation on the Annual Percentage Rate of Charge, can be seen as a step into the right direction. But this legislation requires revision in accordance with the following:

- Information has to be provided at an **early stage** offering the consumer sufficient time for reflection before entering into a contract, **free of charge, easy to access** and **without any constraints**.
- All information should be **personalised** as far as possible and **tailored** to the specific demand and needs of the consumer

255 In *Toker v Westerman*, 274 A.2d 78 (N.J. 1970), the court held: "Suffice it to say that in the instant case the court finds as shocking, and therefore unconscionable, the sale of goods for approximately 36 2 1/2 times their reasonable retail value." The German Supreme Court (IX ZR 9/93 - 04.05.1993) held that "exortionate credit has to be assumed if the contracted interest rate is about double of the average market rate".

with respect to his actual present and future financial situation. Concrete information in money terms which can be related directly to the consumer's cash flow is more valuable than abstract information in percentage rates or other parameters.

- Consumers view debts as part of their cash flow. They can assess their impact only if all cost and risk elements are **translated** into payments from them and to them.

In particular, this would require that all information be provided not only to borrowers personally, but to providers of any security as well, before the agreement is concluded, in order to allow an opportunity for the contents of the information to be taken into account.

This information should be identified for consumers as information required by law to enable comparison of the product with others and to distinguish it from information offered by the financial services provider alone, and it should be contained in a separate leaflet, the contents and lay-out of which should be prescribed by law. This leaflet should be clearly set out and formulated in such a way as to be understandable even for consumers with limited education.

Exercise of the right of withdrawal should be facilitated by a prescribed form, which consumers need only to sign. The forms should also state explicitly that no special reason for withdrawal need be given and that the purpose of the period for withdrawal is to allow time to review the decision. Exercise of the right of withdrawal should not, however, be conditional on use of these forms. Return of the credit agreement should also suffice as conclusive evidence of withdrawal, as would any other means of making clear a desire to withdraw. The time limit for withdrawal should be made the same for all transactions.

In relation to consumer credit agreements, there should be a **re-payment plan** set out in a form prescribed by law. All information relating to payments should be broken down into monthly amounts. This is the only way of providing information related to the liquidity of the consumer, taking account of the fact that over-indebtedness is primarily a problem of liquidity. A column should also be included, in which consumers can enter their individual financial commitments. This column should be completed with the assistance of the credit institution, in order to check that the consumer can afford to take out the loan.

At the very latest by the time the agreement is concluded, information on **crisis management** should be provided and this should be repeated should a delay in repayments arise. In this



context, the rate of interest applicable to arrears should be stated, and details of independent advice centres should be given as a minimum requirement. Better still²⁵⁶, there should be a compulsory discussion between the parties to the credit agreement which would meet minimum requirements.

Borrowers should be **informed expressly of their rights to repay loans early**, as rights serve no purpose if consumers are not aware of them.

In addition to giving written information at the pre-contractual stage, providers should be compelled to inform consumers **orally** of those rights in order to satisfy themselves that consumers have understood the information and in order to answer any queries.²⁵⁷ In particular, this would assist consumers with limited education, who may have difficulties reading the information.

Even if all of these criteria were fulfilled, statutory obligations to provide information can, however, neither afford comprehensive consumer protection nor replace financial literacy programmes in money advice and adult education.

III.A.2.b) Social Consumer Protection (Income Protection)

Credit responds to a need to get money now. It is the offer of a commodity that any human being wants to have because it is a key to the fulfilment of all consumer wishes. It covers weak and strong consumers, those with high income uncertainties and those with a fairly good expectation. Therefore in particular vulnerable consumers will be exposed to the choice between exclusion and acceptance of any form of credit. Their initially sane credit relation will turn into coercion and overindebtedness with unforeseen events in their life and they may end up to the mercy of their creditors if the capital they once took out can not be liquidated again to pay their debts while their income is no longer sufficient to fulfil their duties. In all these cases, consumers will have little choice and markets and competition may not be able to guarantee a spread of costs and risks to all consumers and to protect against additional burden. The law has to compensate for such market failure and, just as in labour law, trade unions started to spread risks by forming a cartel on demand, which was taken later up by workers' protection law. In the absence of such opportunities for debtors' credit law minimum standards have to be offered to spread these risks more evenly.

256 As was compulsory in Germany, although no contents of the discussions were specified.

257 Whitford, W.C.: cf. footnote 60, p 246

This could lead to the following social elements in credit contract law:

- Lender liability for irresponsible lending.
- Flexible Rate ceilings, which if violated give right to a free credit, should ban usurious credit.
- Acceleration clauses should be replaced by cancellation.
- There should be a grace period for debt settlements and debt arrangements of at least 4 weeks.
- Cancellation in Default should be limited to fundamental breach and to cases in which the debtor is in default for more than a month and exceeds ten per cent of the credit or two instalments are in default which exceed five per cent of the credit.
- Consumers in default should have time and opportunities to readapt their credit and payment obligations to their actual situation.
- If the debtor pays the arrears within a significant period of time after default, he gets the right to continue to repay in instalments.
- Default rates should be capped in order to reduce incentives for early cancellation with respect to objective market rates.
- Payments after default should be compounded to the capital first and second interest arrears giving debtors a chance to repay their debts and also an incentive to continue payments.
- Linked credit contracts need special protection because of the lack of freedom debtors often have when contracting new debts.
- Variable rates have to be linked to objective market rates and their inherent risks capped.

III.A.3 A Model Consumer Credit Protection Act

There is an important variety of social consumer protection to cope with overindebtedness in the Member States. There is also a big difference in the development of consumer credit markets and the respective legislation. There are also different structures of financial supervision and procedures to promote consumer interest. Finally, the social welfare systems have quite different offers for overindebted persons. This is why we would recommend on the one hand an improvement of the Consumer Credit Directive to unify the laws where this is possible. On the other hand, as far as social consumer protection is concerned in particular, a Model Consumer Credit Protection Act could be a guideline in the form of an

EU recommendation giving sufficient space for cultural diversities especially in the form of implementation.

For this purpose, we assume that the new Proposal for a Consumer Credit Directive could also serve as a basis for such a model law.

III.A.3.a) The New Proposal for a Consumer Credit Directive in the Light of Overindebtedness

The proposal for a new Consumer Credit Directive has incorporated a large variety of provisions concerning the prevention of overindebtedness through consumer credit in the EU Member States. The study has made extensive reference to these regulations and has, in particular, demonstrated that many of its provisions, especially those on savings' and loan combinations, on variable rate credit, on the disclosure of the APR, on sureties and the protection of guarantors, on repayment tables and default interest as well as credit cancellation and the right for withdrawal, would be an important step forward in inducing creditors to lend more responsibly and give consumers more opportunity to learn about possible risks and better adapt their credit desires to their future capacity to meet repayment requirements.

While the proposal is quite progressive as far as the prevention of overindebtedness is concerned, there are four critical points regarding its scope and its extension in particular, which may affect national consumer protection.

- Some exceptions regarding its scope of application are critical. These concern in particular the total exclusion of mortgage loans, large parts of leasing, of bank credit to bank employees and the limited application on the very sensible subject of credit cards and other overdraft credit even in the light on the improvements.
- With its maximum harmonisation approach the proposal may threaten substantive national consumer protection laws, the variety of which has been elaborated in this report.
- Abolishing the handwritten signature and replacing it by a simple mouse click may lower the barrier to debt.
- The rules on responsibility should be simplified in so far as consumers' responsibility is already regulated in the contract, i.e. the repayment of credit and cost, while the responsibility of the creditor has to be regulated into the contract. Neither consumers' duties nor regulations which place normal risk-taking behaviour of lenders into the custody of the law (such as the duty to inform oneself about the creditworthiness of the applicant) should be inserted into the Directive.

- The proposal could more openly dedicate its regulation to the prevention of overindebtedness and to the protection of consumers. It should be made more effective by linking lenders' responsibility with a principle of lenders' liability.

Some other elements could improve its effects on the prevention of overindebtedness:

- a simplified system for identifying and regulating linked transactions introducing to general principles which will help to prevent further circumvention of the Directive
- a simplified way of calculating and understanding the interest rate regulation
- less exempted products
- the introduction of a number of social consumer protection rules especially on usury and default interest
- an improved right to early repayment
- reintroduction of the general principles of effective application (circumvention) and minimum harmonisation

III.A.3.b) Philosophy and Scope

III.A.3.b)(1) General Approach

Art. 1 does not enumerate the two most important goals of the Directive. Chapters II, III, VI, IX expressly refer to the protection of consumers. Therefore, the prevention of overindebtedness and the principle of consumer protection should be made explicit goals of the Directive in art. 1.

Art. 2 letter b) defines the consumer negatively with reference to "trade, business or profession." The distinction should be made functionally and correspond to the definition of "consumer" under letter a) in so far as the for-profit activity is covered. This is normally done by reference to a "commercial" purpose.

Art. 2 letter c) excludes certain repetitive services from credit. This might be used to exclude financed services at all (such as financed tourism). The important element of credit is already addressed with the words "deferred payment" and "loan". Both indicate sufficiently precisely that capital is provided commercially before the counterobligation is fulfilled. Credit is always the provision of capital defined by the difference in time between the fulfilment of the corresponding obligations in a contract.

Art. 15 of the Directive 87/102/EEC actually in force relating to minimum harmonisation in conformity with the EU Treaty should

be upheld. The proposal should also reinsert the old art. 14 which prevented its derogation through the misuse of legal forms.

III.A.3.b)(2) Scope of Application (Article 3)

Mortgage loans contribute to consumer indebtedness and most national legislations include them into consumer credit legislation or apply similar rules to them. If excluded, the effect will be a split market where suppliers of credit will increasingly try to use unregulated mortgage loans indirectly for lending for all purposes. The legislator will thus endanger the homes of consumers. Besides, there is an increasing second mortgage market. Only those articles concerning early repayment (art. 16) as well as the ban on doorstep contracts (art. 5) and the regulation on linked transaction and the specialties of real estate acquisition would need exemption rules.

The present definition of leasing weakens the actual position of consumers. As contracts are defined by the creditors, it is easy to circumvent the consumer protection provided by means of a simple clause in which the seller retains the property, although amortisation, including the payments of price plus interest, has been achieved. It is then offered to the leasee for the outstanding amount. Economically, there is no difference between such "rent" contracts and instalment purchase or hire purchase contracts. The courts have therefore held that it is not the legal option for the title but the fact that most of the capital is amortised during the lifetime of the contract. This national consumer protection law would be overruled by this definition. This is why an exception is proposed which defines the typical difference between renting (right to cancellation, maintenance of the property) from financing (total governance of the use value of the acquired products).

Credit from employers to employees should be privileged. But the scope of application should be defined more clearly. Where professional lenders give credit to their employees, this is not employer credit, just as nobody would exempt car dealers from consumer protection law if they sell cars to their employees. Bank credit should therefore never be excluded.

The present crisis of the commercial papers market has revealed that many consumers have been lured into debts by false promises of speculating in **commercial papers** on credit. This is the most dangerous form of consumer credit. Why should there be no sufficient information, why no advice and responsibility? As credit for speculation is usually not instalment credit, most articles anyhow would not apply. It would also profit from the exemptions for

overdraft because this is the predominant form of such credit. Finally, the banks can easily make a difference between professional investors and consumers who invest accidentally. In this case, the debtor would not be a consumer. To protect the stock market from overregulation, the Directive could exclude credit contracts where the capital is more than one million euros.

III.A.3.c) Information and Form

III.A.3.c)(1) Internet and Mouseclick should not replace the Written Form

It should be clear that the internet and any medium which allows access and possible subsequent alteration by the provider is not sufficient, because the veracity of the information initially provided is not guaranteed.

Art. 6 no.2 contains the hidden abolition of written information beyond the scope of the distance selling directive. It would in future even allow the e-mailing of information to consumers or issuing of floppy disks. Written information on credit matters is required to provide a basic and necessary warning for those consumers who are at risk of overindebtedness.

The Directive on Distance Selling of Financial Services has accepted the need to put much of the preparatory work for financial services on to the internet. This can be justified because consumers who already use the internet for such products are assumed to be sufficiently e-literate. The exemptions for written information should therefore be restricted to such business and should not affect ordinary credit contracts outside the internet. This could be made clear by a general allusion to this Directive.

III.A.3.c)(2) Tangible Information

An information overload will have no effect on consumers at risk of overindebtedness unless such consumer information is presented in a **standardised general and adequate format**, a format which can be studied and explained in schools and continuing education on financial literacy. Such a standardised format should be prescribed as it is presently in use in the mortgage industry, drawn up by the lenders' associations. Such a format, also successfully used in the United States for Truth in Lending, gives every consumer the chance to quickly identify where and under which headings the necessary information can be found. It would also help the cross-border use of credit.

It should be used for pre-contractual as well as contractual information.

Experience in consumer protection has shown that consumers do not think in abstract categories but look at the individual payments with regard to their monthly income and expenditure. This is why repayment table, based on the terms of the contract, in the form of a cash flow table is the most adequate form of consumer information. All the other information is secondary but is still required for price comparison and shopping around. It should also be harmonised in the way that the European mortgage banks have agreed to provide information in the same format throughout Europe. This would also facilitate cross-border sales of credit because even in a foreign language consumers would know exactly where to look for information. These have long been used in the American Uniform Consumer Credit Code for APR disclosure, and do not hinder competition or product sales because they represent the products in a uniformly understandable language.

There should be no incentive for lenders to cancel credit agreements only in order to gain higher interest than before.

III.A.3.c)(3) The Annual Percentage Rate of Charge

There are two conflicting definitions of the APR in the Directive, the cost orientated definition in art. 2 and the growth orientated definition in art. 12. The Directive should be streamlined to form one single definition of cost of credit and annual percentage rate of charge. As only the growth rate is mathematically correct and as consumers can refer the burden of credit to their monthly income only if all payments (and not only cost elements) are taken into account, the Directive should use only this definition which is based on the cash flow between creditor and debtor and thus on the amortisation table, which is important for the consumer to understand the effects of the credit on the future liquidity of his household.

III.A.3.c)(4) Usury Protection

Nearly all European countries have usury rates or rate ceilings which prevent exorbitant pricing in credit and a systematic exploitation of consumers who feel or are personally forced to take up credit, to prolong credit at any price. While most countries such as *France, Italy, the Netherlands, Belgium, Luxembourg* and the *Scandinavian* countries prefer administratively-fixed rate ceilings, *Germany* uses the old systems of usury linked to "bona fide". In all systems, the rate ceiling is fixed according to a market rate at about 150 to 200% of the average market rate in consumer credit. This margin gives enough space to allocate different risks and service intensity in consumer credit and have proved to be acceptable to the credit industry. The increase in confidence and trust in such

regulated consumer credit systems has actually kept the exclusion rate quite low, while those few countries who still accept credit extension at any rate have experienced a withdrawal by banks from this area, increased denial of access and a grey market which is a particular threat to those consumers who face temporary income problems or are already overindebted. All the goals of this Directive, harmonisation, consumer protection and the prevention of overindebtedness necessitate this core regulation. The present situation basically leads to different systems of cost allocation and hinders cross-border credit extension. These act to the detriment of the economic interests of weak consumers and they are, to a large extent, a reason for overindebtedness which increases through scrupulous refinancing and ever higher interest rates.

Various models of sanction are possible. If only those parts of the credit costs are not due which surmount the usury rate, usury would be without risk for the creditor. The same is also true for those sanctions where the APR is reduced to the average market rate. Only if the credit is costless in case of usury creditors will have sufficient risk to observe these rules and consumers sufficient incentives to pursue their rights.

The campaign during the eighties in *Germany* demonstrated that less than 5% of those who would have been entitled to a refund took advantage of this strict German regulation. But it has been effective in so far as openly usurious credit has become the exemption. At present, usurious credit is hidden in linked transactions, a problem which this Directive also addressed.

III.A.3.d) Default and Responsibility

III.A.3.d)(1) Early Repayment

Some countries have misinterpreted the previous right to early repayment by introducing a time period for a minimum lifetime of the credit, which may even amount to one year, as in *Germany*. It should be clear that effective discharge is possible only if the consumer can repay his debt at any time without penalty.

The proposal now seems to allow indemnities. This will destroy the afore-mentioned effects. If the regulation is to be effective, no "new" indemnities should be able to be claimed, but only fees which cover the costs arising from the administration of the early repayment.

Lenders have sufficient protection through the fact that refunds are limited to interest and those insurance premiums and other fees which can be seen as the counterpart of future services. In

particular, it does not include the initial fees so that lenders are compensated for their closing efforts.

Furthermore, clear and strict rule makes further exemptions unnecessary and streamlines the directive.

III.A.3.d)(2) Responsible Lending and Borrowing

There is no reason to impose a legal obligation on consumers to reply accurately to their creditors. Such obligations already exist in contract law, and there are no exemptions. Creditors have long agreed to such obligations and the courts enforce them. It is questionable as to whether the Directive should regulate such openly defined obligations ("necessary, adequate and not excessive") without providing any sanctions for their violation. It may serve as a pretext to deny access to credit.

Art. 7 ff. offer a problematic explanation of overindebtedness to the credit industry.

All empirical data reveal that most of those credit contracts, where consumers run into repayment difficulties, have been concluded in a situation where the repayment was actually feasible. Unforeseen events, such as unemployment, loss of income, illness, divorce and health problems cause difficulties in household liquidity which in turn transfer into credit problems.²⁵⁸

Increasingly, consumers are cut off from credit resources because banks feel that small credit amounts do not generate sufficient profit. If a database is made obligatory it may also serve as an easy pretext for excluding low income consumers from further credit supply. Creditors will argue that the law does not allow them to give access to credit to certain consumers. Banks should have the possibility of extending credit to consumers in difficult situations and with a bad credit history provided they can reasonably assume that this capital will effectively help such consumers to recover economically, to restructure their debts and to earn own income.

III.A.3.d)(3) Protection of Guarantors

In letter f) protection of guarantors should not be linked to the legal form of the guarantee. There may be other forms where the property of third persons is offered as a surety within the surety agreement of a third person.²⁵⁹

258 See already Caplovitz, D.: Consumers in Trouble - A study of Debtors in Default, cf. footnote 3

259 See the German system of unlinked securities, such as the "Grundschild".

III.A.3.e) Dangerous Products and Problematic Situations

III.A.3.e)(1) Linked Transactions

The number of interesting and good rules on linked transactions could be reduced if under a new letter d), the Directive would introduce a general definition for "linked transactions" as a modern form of consumer credit. This would prevent loopholes and circumvention. The definition should comprise all forms of package credit where credit is integrated into financial services, such as endowment credit contracts, special bank accounts or credit cards which allocate cost elements into a different product, financial leasing or financed transactions where cost elements are hidden in the remuneration of other services. A modern directive should recognise that the enormous development in consumer financing no longer involves traditional loans and instalment contracts alone, but increasingly, the whole range of financial services.

In art. 6 no. 4., it is not clear why creditors in linked transactions should be totally exempt from information duties. Overindebtedness stems mainly from credit card debts, linked transactions from mail-order companies or big department stores. These are usually last resort credit sources when no other bank credit is available. In these cases in particular, consumers should be aware that the temptation of the immediate acquisition of the goods and services they want, obscures the full extent of the debt they are incurring. If these creditors extend such credit on a regular basis (which is usually the case, because such credit is not extended through small businesses without help of a bank), they can also afford to use computerized print-outs for the necessary information.

III.A.3.e)(2) Credit Intermediaries

The definition of "credit intermediaries" in the old letter d) – now e) – is too narrow. Letter e) should again use the word "commercially" to define consumer credit. It should omit the description as to how intermediaries earn their fees because this is not exhaustive. Sometimes, they get their money from the creditor, sometimes they charge the debtor. The definition given is too complicated.

III.A.3.e)(3) Variable Rates

Variable rates shift the risk of market fluctuations to the consumer. This is why a detailed regulation has to be drawn up in order to prevent unforeseen changes, arbitrary use of it and, in turn, overindebtedness.

For this purpose its scattered regulation as a standard contract term regulation (art. 15) and a strict regulation (art. 14 nos. 3 and 4) should be integrated into one paragraph in art. 14 no. 3.

III.A.3.e)(4) Overdraft

Art.17 of the proposal would forbid credit lines which would give consumers more security in credit use. It should be made clear that if consumers reach an agreement which guarantees the credit line for longer than three months this is still possible. A consumer protection directive should not include the rights of the supplier.

III.A.3.f) Draft of a Model Consumer Credit Protection Act

CHAPTER 1: AIM, DEFINITIONS AND SCOPE

Article 1 Aim

The aim of this law is to protect consumers, to provide sane commercial practices and to prevent overindebtedness concerning agreements covering credit granted to consumers and surety agreements entered into by consumers.

Article 2 Definitions

b) "creditor" means a natural or legal person who grants or promises to grant credit commercially;

c) "credit agreement" means an agreement whereby a creditor grants or promises to grant to a consumer credit in the form of a deferred payment, loan or other similar financial accommodation;

d) "linked transaction" any other agreement linked to the credit in order to facilitate economically the extension of credit, the provision of capital, the administration of the credit, the form or safety of its repayment; a linked transaction is one where

1. the repayment of the capital is deviated for future amortisation into any form of savings, endowments, capital life or other investment ("endowment credit");

2. payment services are primarily provided to facilitate credit administration and repayment;

3. the purchase of goods or services is financed by the credit agreement and where the provider has participated in the provision of the credit or the creditor in the provision of those purchases in any form ("financed contracts");

4. the fulfilment of any form of credit granted to a natural or legal person is guaranteed by a consumer ("surety agreement");

5. *an insurance contract credit is concluded if the insurance is taken out when the credit agreement;*

e) *"credit intermediary" means a natural or legal person who acts commercially as an intermediary by presenting or offering credit agreements, undertaking other preparatory work for such agreements, or concluding such agreements;*

f) *"guarantor" means a consumer providing any surety for the credit by consent;*

g) *"total cost of credit to the consumer" means all the costs, including borrowing interest, indemnities, commissions, taxes, insurance premiums and any other kind of charge which the consumer has to pay to facilitate the credit within the credit agreement or any other linked transaction;*

h) *"annual percentage rate of charge" means the rate of charge, which equates, on an annual basis, the present value of all commitments (drawdowns, repayments and charges), future or existing, agreed by the creditor and the borrower consented in the credit agreement or any linked transaction;*

i) *"usury rate" means an "annual percentage rate of charge" whose calculation and adaptation to market conditions is defined by law according to an average interest rates fixed objectively by a public body in regular time intervals which is multiplied with a legally defined factor in order to limit the cost which can be convened in consumer credit contracts;*

j) *"calculation rate" means the interest rate used to calculate the sums owed to the creditor for the use of the amount of credit drawn down;*

k) *"residual value" means the price of the financed goods or services applicable at the time when the option or the property transfer option is exercised;*

l) *"drawdown" means an amount of credit made available to the consumer in the form of a deferred payment, loan or other similar financial accommodation;*

m) *"total amount of credit" means the ceiling or the sum of all drawdowns that are likely to be agreed;*

n) *"durable medium" means any instrument which enables the consumer to store information addressed personally to him in a way which makes it exclusively accessible to him for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored.*

Article 3 Scope

1. This directive applies to credit agreements and surety agreements and, where applicable, to linked transactions.

2. This directive shall in total or partially as indicated not apply to the following credit agreements and, where applicable, any corresponding surety agreements:

a) Art. 5, 16, 19 to credit agreements the aim of which is to grant credit for the purchase or transformation of private immovable property that the consumer owns or is seeking to acquire and which are secured either by a mortgage on immovable property or by a surety commonly used in a Member State for this purpose;

b) hiring agreements unless the consumer has no right to cancellation and during the lifetime of the contract the total payments made in this contract and any other linked transaction equals less than 80% of the cash price plus average financing fees;

c) credit agreements under the terms of which the consumer is required to repay the credit in a single payment within a period not exceeding three months, without the payment of interest or any other charges;

d) credit agreements which meet the following conditions:

(i) they are granted by an employer to the employee as a secondary activity, i.e. outside the sphere of his principal commercial or professional activity,

(ii) they are granted at annual percentage rates of charge lower than those prevailing on the market, and

(iii) they are not offered to the public generally,

(iiii) have fixed instalments and are not linked directly to the labour contract;

e) credit contracts where the capital is more than one million euros.

CHAPTER II – INFORMATION AND PRACTICES PRELIMINARY TO THE FORMATION OF THE AGREEMENT

Article 4 Advertising

Without prejudice to Council Directive 84/450/EEC, any advertising or any offer displayed at business premises that includes information on the cost of credit, especially on fees, repayment facilities and amounts or the, total calculation rate should also reveal the annual percentage rate of charge and the conditions under which such product is available. All information shall be provided in a



clear and comprehensible manner, with due regard, in particular, to the principles of good faith in commercial transactions. The commercial purpose of this information must be made clear.

Article 5 Ban on Negotiation of Credit and Surety Agreements outside Business Premises

The negotiation of a credit or a surety agreement outside business premises in the circumstances referred to in Article 1 of Council Directive 85/577/EEC shall be prohibited.

Article 6 Exchange of Information in Advance and Duty to Provide Advice

1. The creditor shall provide the consumer in writing with all the exact and complete information needed in respect of the credit agreement under consideration, the product its advantages and drawbacks for such consumers which usually apply for these products before the conclusion of the credit agreement. In particular the information must refer to:

- a) the sureties and insurance required;*
- b) the duration of the credit agreement and the amount, number and frequency of payments to be made shown in a table of payments in which, for each period, the time (days of month), the applicable interest rate, as well as those parts of the payment needed for the payment of interest and for the amortisation of the capital is clearly visible and uses the form in Annex 2 of this directive;*
- c) the recurrent and non-recurrent charges, including additional non-recurring costs which the consumer has to pay on concluding a credit agreement, such as taxes, administrative costs, legal fees and assessment costs with regard to the sureties required;*
- d) the total amount of credit and the conditions governing the drawdown of the credit;*
- e) where applicable, the cash price of the financed goods or services, the down payment due and the residual value;*
- f) where applicable, the calculation rate, the conditions governing the application of this rate and any index or reference rate applicable to the initial calculation rate, as well as the periods, conditions and procedures for varying the calculation rate;*
- g) the annual percentage rate of charge and the total calculation rate, by means of a representative example mentioning all the financial data and assumptions used for calculating the said rates;*

h) the period during which the right of withdrawal may be exercised and the costs passed on to the consumers. In the cases referred to in Article 3 (3) of the Directive on the Distance Marketing of Financial Services to Consumers and amending Council Directives 90/619/EEC, 97/7/EC and 98/27/EC, this information must include at least the items referred to in points c), e), and h) of this paragraph in the form allowed by this directive.

3. The Commission will be empowered to draw up a standardised formual which has to be used by all suppliers to give the information prescribed by this directive.

CHAPTER III – PROTECTION OF PRIVACY

Article 7 Collection and Processing of Data

1. Personal data obtained from consumers, guarantors or any other person in connection with the conclusion and management of agreements covered by this directive may be processed only for the purpose of assessing the financial situation of those persons and their ability to repay.

2. The consumer and, where appropriate, the guarantor shall, if they so request, be informed of the result of any consultation immediately and without charge.

3. Personal data received under paragraph 1 may be processed only for the purpose of assessing the financial situation of the consumer and guarantor and their ability to repay. The data shall be destroyed immediately after the conclusion of the credit or surety agreement or the refusal by the creditor of the application for credit or the proposed surety.

CHAPTER IV: FORMATION OF CREDIT AND SURETY AGREEMENTS

Article 9 Responsible Lending

The creditor is liable for damages caused by the sale of such credit contracts which are obviously inadequate with regard to the financial situation of the consumer, his prospective ability for repayment, the purpose of the credit, its costs and those specific risks of the consumer or his group which the creditor should know.

Article 10 Information that must be included in Credit and Surety Agreements

1. Credit agreements and surety agreements shall be drawn up on paper. All the contracting parties, including the guarantor and the credit intermediary, shall receive a copy of the credit agreement. The guarantor shall receive a copy of the surety agreement. Agreements shall mention the existence or non-existence of out-



of-court complaint and redress procedures accessible to consumers who are party to a contract and, if such procedures exist, the formalities for gaining access to them.

2. The credit agreement shall include:

a) the names and addresses of the contracting parties as well as the name and address of the credit intermediary involved;

b) the data referred to in Article 6 (2), with the annual percentage rate of charge and the lending rate calculated at the time the credit agreement is concluded on the basis of all the financial data and assumptions applicable to the agreement;

c) where capital amortisation is involved, a statement of account in the form of an amortisation table, the payments owing, and the periods and conditions relating to the payment of these amounts;

d) if charges and interest are to be paid without capital amortisation, a statement showing the periods and conditions for the payment of the borrowing interest and of the associated recurrent and non-recurrent charges;

e) a statement of the cost components that are not included in the calculation of the annual percentage rate of charge but are to be paid by the consumer under certain circumstances, namely the commitment fee, the charges relating to unauthorised drawdowns in excess of the total amount of credit and the charges for defaulting, plus a list setting out the circumstances;

f) where applicable, the goods and/or services being financed;

g) entitlement to early repayment, as well as the procedure to be applied by the consumer in order to exercise this right;

h) the procedure to be followed to exercise the right of withdrawal.

The table referred to in c) shall contain a breakdown of each repayment to show capital amortisation, the interest calculated on the basis of the calculation rate and, where applicable, the additional costs and its compounding. If, in the case referred to in c), a new drawdown is not possible without the consent of the creditor, the creditor's decision shall be communicated on paper or on another durable medium. It shall be made available to the consumer and contain the amended data to which this paragraph refers. Where the exact amount of these components referred to in e) is known, it shall be shown. Otherwise, and as a minimum requirement, these costs must be ascertainable in the credit agreement on the basis of an indication of the percentage linked to a reference rate, a calculation method or the most realistic estimate possible. In such cases the creditor shall make available to the

consumer on paper or on another durable medium a breakdown of these costs without delay or, at the latest, when they are to be applied.

3. The surety agreement shall state the maximum amount guaranteed, as well as the charges for defaulting to be applied in accordance with the procedure referred to in paragraph 2 (e).

Article 11 Right of Withdrawal

1. The consumer shall either have a period of fourteen calendar days to withdraw his acceptance of the credit agreement without giving any reason. This period shall begin on the day a copy of the credit agreement concluded is transmitted to the consumer.

2. The consumer shall notify the creditor of his withdrawal before expiry of the period referred to in paragraph 1 and in accordance with national legislation regarding proof. The deadline shall be deemed to have been observed if this notification, which must be on paper or on another durable medium that is available and accessible to the creditor, is dispatched before the deadline expires.

3. Exercise of the right of withdrawal shall oblige the consumer simultaneously to return to the creditor the sums of money or goods that he has received by virtue of the credit agreement, in so far as provision thereof is governed by the credit agreement. The consumer shall pay interest due for the period during which credit was drawn, calculated on the basis of the agreed annual percentage rate of charge. No other indemnity may be claimed in connection with withdrawal. Any down payment effected by the consumer under the credit agreement shall be repaid to the consumer without delay.

4. Paragraphs 1, 2 and 3 shall not apply if the consumer has got a complete binding offer from the creditor which is valid for fourteen days.

CHAPTER V – ANNUAL PERCENTAGE RATE OF CHARGE AND CALCULATION RATE

Article 12 Annual Percentage Rate of Charge

1. The annual percentage rate of charge, which equates, on an annual basis, the present value of all commitments (drawdowns, repayments and charges), future or existing, agreed by the creditor and the borrower, shall be calculated in accordance with the mathematically correct formula representing the growth of capital according to a rate in which the exponent contains the time expressed in days divided by 365.25 days. The method is explained in Annex I and Annex II, by way of illustration.



2. For the purpose of calculating the annual percentage rate of charge, the cash flow shall be determined including any kind of payments within linked transactions, with the exception of charges payable by the consumer for non-compliance with any of his commitments laid down in the credit agreement.

3. The calculation of the annual percentage rate of charge shall be based on the assumption that the credit contract will remain valid for the period agreed and the creditor and the consumer will fulfil their obligations under the terms and by the dates agreed.

4. In the case of credit agreements containing clauses allowing variations in the calculation rate contained in the annual percentage rate of charge but unquantifiable at the time of calculation, the annual percentage rate of charge shall be calculated on the assumption that the calculation rate and other charges will remain fixed in relation to the initial level and will remain applicable until the end of the credit agreement.

5. Where necessary, the following assumptions may be adopted in calculating the annual percentage rate of charge:

a) if a credit agreement gives the consumer freedom of drawdown, half of the total amount of credit shall be deemed to be drawn down immediately and in full;

b) if there is no fixed timetable for repayment, and one cannot be deduced from the terms of the agreement and the means for repaying the credit granted, the duration of the credit shall be deemed to be one year;

c) unless otherwise specified, where the agreement provides for more than one repayment date, the credit will be made available and the repayments made on the earliest date provided for in the agreement.

6. Where a credit agreement is drawn up in the form of a hire agreement with an option to purchase and the agreement provides for a number of dates on which the purchase option may be exercised, the annual percentage rate of charge shall be calculated for each of these dates. Where the residual value cannot be determined, the goods hired shall be subject to linear amortisation that makes its value equal to zero at the end of the normal hire period laid down in the credit agreement.

Article 13 Usury and Default Interest Rate

1. A remuneration for the extension of credit may be charged only if the annual percentage rate of charge is less than the usury rate.



2. Member States will regulate the maximum interest rate charged on the outstanding capital in case of default in a way that it will not surpass the calculation rate agreed to in the credit contract.

Article 14 Calculation Rate

1. The calculation rate may be fixed or variable.
2. Where one or a number of fixed calculation rates have been established, they shall apply for the duration of the period specified in the credit agreement. The contract shall indicate the maximum instalment which can be expected under this contract.
3. A variable calculation rate shall vary until the end of agreed even periods provided for in the credit agreement if the agreed objective index or reference rate deviates at a certain margin. It shall relate to the net initial calculation rate proposed when the credit agreement was concluded and should not exclude all forms of rebate, reduction or other advantages. The consumer shall be informed of any change to the calculation rate, on paper or on another durable medium. This information must include the new annual percentage rate of charge and, where applicable, the new amortisation table. The calculation of the new annual percentage rate of charge shall be based on Article 12 (3).

CHAPTER VI – UNFAIR TERMS

Article 15 Unfair Terms

Without prejudice to the application of Directive 93/13/EEC to the agreement as a whole or to the implication the clauses may have for other rules of this directive, terms in a credit agreement or surety agreement shall be regarded as unfair if their object or effect is to:

- a) impose on the consumer, as a condition for a drawdown, a requirement to leave as surety, in full or in part, the sums borrowed or granted, or to use them, in full or in part, to constitute a deposit or purchase securities or other financial instruments, unless the consumer obtains the same rate for such deposit, purchase or surety as the agreed annual percentage rate of charge;
- b) oblige the consumer, when concluding a credit agreement, to enter into another contract with the creditor, credit intermediary or a third party designated by them, unless the costs thereof are included in the total cost of the credit;
- c) vary any contractual costs, indemnities or charges other than the calculation rate;
- d) oblige the consumer to use the same creditor to refinance the residual value and, in general, any final payment on a credit



agreement for financing the purchase of movable property or a service.

CHAPTER VII – PERFORMANCE OF A CREDIT AGREEMENT

Article 16 Early Repayment

- 1. The consumer shall be entitled to discharge fully or partially his obligations under a credit agreement at any time before the time fixed in the agreement.*
- 2. The consumer shall have a right to a full refund of prepaid or precalculated interest or other payments within linked transactions inherent in the outstanding debt. No indemnity shall be claimed.*

CHAPTER VIII – SPECIFIC CREDIT AGREEMENTS

Article 17 Separation of Amortisation and Credit Agreements in Linked Transactions

- 1. If payments made by the consumer do not give rise to an immediate corresponding amortisation of the total amount of credit, but are used to constitute capital during periods and under conditions laid down in the credit agreement, such constitution of capital shall be based on an ancillary agreement attached to the credit agreement.*
- 2. The ancillary agreement referred to in paragraph 1 shall provide for an unconditional guarantee of repayment of the total amount of credit drawn down. If the third party fails to comply with his obligations, the creditor shall assume the risk.*
- 3. Payments, premiums and recurrent or non-recurrent charges payable by the consumer under the ancillary agreement referred to in paragraph 1, together with interest and charges under the credit agreement, shall constitute the total cost of the credit. The annual percentage rate of charge and the total lending rate shall be calculated on the basis of the total commitment subscribed to by the consumer.*

Article 18 Open-End Credit Agreement

Either party may terminate an open-end credit agreement by giving three months' notice drawn up on paper or on another durable medium in accordance with the procedures laid down in the credit agreement and in accordance with national legislation regarding proof irrespective of a more favourable agreement for the consumer.

CHAPTER IX: PERFORMANCE OF A SURETY AGREEMENT

Article 19 Performance of a Surety Agreement

- 1. A guarantor may conclude a surety agreement guaranteeing repayment under an open-end credit agreement for a period of three years only. This surety may be extended only with the specific agreement of the guarantor at the end of that period.*
- 2. The creditor may take action against the guarantor only if the consumer, having defaulted on repayment of the credit, has failed to comply with a default notice within three months.*
- 3. The amount guaranteed may only equal the outstanding balance of the total amount of credit and any arrears in accordance with the credit agreement, with the exclusion of any other indemnities or penalties provided for by the credit agreement.*

CHAPTER X: NON-PERFORMANCE OF A CREDIT AGREEMENT

Article 20 Default notice and enforceability

- 1. Member States shall ensure that:*
 - a) creditors, their representatives and any other assignee of the creditor's rights under a credit agreement or surety agreement may not take disproportionate measures to recover amounts due to them in the event of non-performance of such agreements;*
 - b) the creditor may demand immediate payment in the event of default or invoke a clause providing an express resolute condition only through a prior default notice requesting the consumer or, where applicable, the guarantor to comply with his obligations under the agreement within a reasonable period of time or to apply for rescheduling of the debt;*
 - c) the creditor may not suspend the consumer's drawdown rights unless he justifies his decision and is required to inform the consumer without delay;*
 - d) in the event of non-performance of their obligations or in the event of early repayment, the consumer and the guarantor are entitled, on request and without delay, to receive a detailed statement of account, free of charge, allowing them to verify the charges and interest claimed.*
- 2. A default notice as referred to in paragraph 1 (b) is not necessary:*
 - a) in the event of manifest fraud, evidence of which shall be provided by the creditor or the assignee of the creditor's rights;*
 - b) where the consumer alienates the property financed before the total amount of credit is repaid or uses the property in a manner*



inconsistent with the conditions of the credit agreement, and where the creditor or the assignee of the creditor's rights has a preferential claim, right of possession or reservation of title on the property financed, provided that the consumer has been informed of the existence of such preferential claim, right of possession or reservation of title prior to the conclusion of the contract.

Article 21 Overrunning of the total amount of credit and tacit overdraft

1. In the event of an authorised temporary overrunning of the total amount of credit or a tacit overdraft, the creditor shall inform the consumer without delay, in writing or on another durable medium, of the amount involved and the borrowing rate applicable. No penalties, charges or interest on arrears shall be included.

2. The creditor shall inform the consumer without delay that he has overrun the credit amount or is in an unauthorised overdraft situation and shall inform him of the borrowing rate and/or the charges or penalties applicable.

3. Any overrunning or overdraft as referred to in this article shall be rectified within three months, where necessary through a new credit agreement providing for a higher total amount of credit.

Article 22 Repossession of goods

In the case of credit agreements for the acquisition of goods, Member States shall lay down the conditions under which goods may be repossessed. If the consumer has not given his specific consent at the moment the creditor proceeds for repossession and if he has already made payments corresponding to a third of the total amount of credit, the goods financed may not be repossessed unless by judicial proceedings. Member States shall further ensure that, where the creditor repossess the goods, the account between the parties is made up so as to ensure that repossession does not entail any unjustified enrichment.

Article 23 Recovery

1. Natural or legal persons who undertake, as their principal or as a secondary activity, and not as part of any court procedure, the recovery of debts arising from a credit agreement or surety agreement, or who intervene in this respect, may not, in any form whatsoever, either directly or indirectly, claim any fee or indemnity from the consumer or guarantor for their intervention, unless such fees or indemnities are specifically agreed in the credit agreement or surety agreement.

2. In the context of the recovery of debts arising from a credit agreement or surety agreement, the following shall be prohibited:



- a) any document which, as a result of its appearance, wrongly gives the impression that it is from a judicial or debt mediation authority;*
- b) written communications containing incorrect information on the consequences of defaulting on payment;*
- c) unauthorised repossession of goods without judicial proceedings or the specific consent referred to in Article 26;*
- d) any inscription on an envelope which makes it clear that the correspondence concerns the recovery of a debt;*
- e) collection of charges not provided for by the credit agreement or surety agreement;*
- f) any contact with the neighbours, relatives or employer of the consumer or guarantor, especially any communication of, or request for, information on the solvency of the consumer or guarantor, without prejudice to actions forming part of statutory seizure procedures as established by Member States;*
- g) physical or psychological harassment of a consumer or guarantor; h) recovery of a lapsed debt.*

CHAPTER XI: REGISTRATION, STATUS AND CONTROL OF CREDITORS AND CREDIT INTERMEDIARIES

Article 24 Registration of creditors and credit intermediaries

1. Member States shall ensure that creditors and credit intermediaries apply for registration. The obligation to register does not apply to credit intermediaries for whom a creditor or another credit intermediary assumes responsibility under the terms of his own registration. This assumption of responsibility must be made clear in a notice on the premises of credit intermediaries not required to register.

2. Member States shall:

- a) ensure that the activities of creditors and credit intermediaries are subject to inspection or monitoring by an institution or official body;*
- b) establish appropriate bodies to receive complaints concerning credit agreements, surety agreements and credit and surety conditions, and to provide consumers and guarantors with relevant information or advice on this subject.*

3. Member States may stipulate that registration as referred to in the first subparagraph of paragraph 1 of this article shall not be necessary where the creditor or credit intermediary concerned is a



"credit institution" within the meaning of Article 1(1) of Directive 2000/12/EC of the European Parliament and of the Council and is authorised in accordance with the provisions of that directive. Where a creditor or credit intermediary is both registered under the provisions of the first subparagraph of paragraph 1 of this article and authorised under the provisions of Directive 2000/12/EC of the European Parliament and of the Council, and the latter authorisation is subsequently withdrawn, the competent authority which has registered the creditor or credit intermediary shall be informed and shall decide whether the creditor or credit intermediary may continue to grant or arrange credit or whether his registration should be cancelled.

Article 25 Obligations of credit intermediaries

Member States shall ensure that a credit intermediary:

- a) indicates in advertising and documentation intended for clients the extent of his powers, in particular whether he works exclusively with one or more creditors or as an independent broker;*
- b) communicates to all creditors contacted the total amount of other credit offers he has requested or received for the same consumer or guarantor during the two months preceding conclusion of the credit agreement;*
- c) does not receive, directly or indirectly, any fee, in whatever form, from a consumer who has requested his services, unless all the following conditions are met: i) the amount of the fee is stated in the credit agreement, ii) the credit intermediary does not receive a fee from the creditor, iii) the credit agreement for which he has acted is actually concluded.*

CHAPTER X: NON-PERFORMANCE OF A CREDIT AGREEMENT

Article 26 Circumvention and Minimum-Harmonisation

1. Member States shall ensure that credit agreements shall not derogate, to the detriment of the consumer, from the provisions of national law implementing or corresponding to this Directive. Member States shall further ensure that the provisions which they adopt in implementation of this directive are not circumvented as a result of the way in which agreements are formulated, in particular by the devise of distributing the amount of credit over several agreements.

2. This directive shall not preclude Member States from retaining or adopting more stringent provisions to protect consumers consistent with their obligations under the Treaty.

ANNEX I

The calculation is done on the basis that a capital C_0 (present value) grows in t years with a growth-rate of $(1+i)$ (if i is the traditional interest rate) into a capital C_t (future value) according to the formula:

$$C_t = C_0(1+i)^t$$

The APR is calculated with a spreadsheet.

In this spreadsheet, the first column contains all the data of payments agreed in the credit contract as well as in linked agreements (payment of the capital, interest payments and repayments as well as costs which are debited to the account). The payments of the creditor have to be entered in the second column and those of the consumer into the third column.

The fourth column serves to calculate the APR. Its first row contains the saldo of payments at the first date. This is where the credit started. The second row is calculated out of the figures in the first row plus the payments of the creditor minus the payments of the debtor in the second row multiplied with a growth rate which is $1 +$ an interest rate which should be recorded in an extra space. This growth rate will have an exponent which is the difference between the date of the second row and the date of the first row in days divided by 365,125.

The APR is then calculated by using the "target value" function of a spreadsheet which tries out interest rates until the last row of the fourth column contains the future value which is the sum due at the end of the credit contract (normally "0").

III.B Insolvency Legislation

III.B.1 Findings

Today ten out of 15 Member States have consumer insolvency legislation. Both *Italy* and *Portugal* are in the process of preparing such laws. In *France* too, where discharge of debt has been possible only to a limited extent, a reform aiming at wider discharge provisions is pending. Only *Greece*, *Ireland* and *Spain* have not started a serious legal policy discussion on consumer insolvency regulation.

Thus we can conclude that consumer insolvency law has become a part of a European legal tradition. As the consumer credit market is expanding to the *Southern* Member States as well as to the new Member States that will join the European Union in 2004, it is important to emphasize that the problems of overindebted debtors

must be taken seriously in all Member States and that the need for consumer insolvency legislation is acknowledged.

By consumer insolvency law we refer to such laws that provide for a partial or total discharge of debt, that are accessible to consumers and other private debtors at reasonable cost and that include debtor's assets, future income and all debts in the same arrangement.

The overview of the European laws in Chapter II.D shows that the laws are quite different. No harmonization has taken place so far. We do not consider this as a serious problem since the laws share some common principles. We need to point out, however, that access to discharge is limited in some countries, especially in *France*, the *United Kingdom* and to some extent in *Sweden*, which gives some reason for concern in these countries.

The general principles we can distinguish in European laws are rehabilitation, earned start through a payment plan, access to insolvency proceedings without prohibitive costs, availability of counselling and a preference for out-of-court or pre-court procedures.

Rehabilitation of debtors as economic actors is the core of consumer insolvency law. It is mainly achieved through discharge from excessive debt burden, but it would be wrong to conclude that discharge is the only measure for achieving rehabilitation. It is equally important to note the role of debt counselling and other social services that are available in European countries.

Essential for the European rehabilitation concept is that the discharge should be as broad as possible. To offer a real chance of rehabilitation, the discharge should cover almost all the debtor's debts. Only alimony payments are commonly excluded from discharge and some countries limit this exception to alimonies paid directly to the child. In some countries, tort claims for deliberate damage and fines are also excluded from discharge. Notwithstanding these limited exceptions, discharge in European context covers most debts. Also, some debts are given preferential treatment in consumer insolvency. Priorities have been reduced in general insolvency and bankruptcy law and in consumer insolvency law they are even fewer. It has to be noted that European laws do not accept affirmation agreements, that is, agreements between the debtor and a creditor about payment of a debt notwithstanding discharge.

These general principles apply only to unsecured debt. As regards secured debt, no general policies can be distinguished so far. Some countries protect home owning debtors (especially *Finland*,



France and Norway). *Austria and Germany* accept contract-based wage assignments made before the insolvency proceedings. This causes all kinds of trouble in terms of the proceedings. It should be noted that consumer insolvency laws do not affect the legal situation of persons who have given personal guarantees for a loan or who are co-debtors on some other grounds. This is a serious problem for which no easy solution is in sight.

The second principle of European consumer insolvency law is earned start through a payment plan. None of the Member States allow for a quick fresh start without a mandatory payment plan. On the contrary, a payment plan is an essential requirement for achieving discharge. The duration of the payment plan is usually five years (see more in detail II.D.4.e)(2)). It is generally accepted in the Member States that the payment plan should be onerous. The debtor is obliged to use all his income that is not required for living costs to pay off the debts. The living costs of the debtor and his family are calculated using the minimum level of social assistance as a starting point. Part of this rigorous, almost punitive attitude, is the regulation of what assets the debtor may keep. In many countries reference is made to the regulations forming part of debt enforcement law, which in turn enumerates domestic assets and the tools for trade in a restrictive way.

This attitude and these regulations are used to refute claims that consumer insolvency is an easy way out and a heaven for ruthless debtors. Recent studies show that the requirements of the payment plan may be quite difficult for ordinary debtors even with a decent income. These debtors have usually suffered considerably before they file for consumer insolvency. It is probably time to ask whether it is sensible to make middle class people who have the resources to be productive members of society to live on the subsistence minimum for five years just to satisfy the jealousy of their neighbours.

Open access to insolvency proceedings without prohibitive costs is a third principle that can be distinguished in European insolvency laws. All laws contain some restrictions for debtors who do not act in good faith. These restrictions are more numerous and restrictive in the Nordic countries than in Central European countries.

The principle of no prohibitive costs is, on the contrary, generally accepted. As far as we can see, all Member States give a high priority to adequate assistance for overindebted debtors. In most cases, debt counselling programmes and agencies are promoted and supported by state funds. Also free legal aid is available, but it is in some cases subsidiary to debt counselling services. These services help debtors to file for consumer insolvency and to nego-

tiate with creditors when that is the right measure. Other social services are also provided. Debt counselling services are either free or provided at low cost to the debtors.

Most Member States have expressed a clear preference for out-of-court or pre-court procedures over formal insolvency proceedings in the courts. The only exceptions seem to be *Denmark* and the *United Kingdom* where no pre-court attempts at settlement are required.

In Chapter II.D.3 we distinguished between contract-based voluntary settlements and institutionalized pre-court arrangements. Countries seem to be divided over these two approaches and no preference for one or the other can be distinguished. We would like to see the existence of different proceedings as an advantage. Since these laws operate in different legal and social traditions and debtors' situations vary considerably, the available remedies should be similarly varied.

Since pre-court procedures are a clearly-stated policy goal, it is worth noting that the success of such procedures is not guaranteed and it is difficult to measure. We noted above, however, that a tradition of professional debt counselling is an essential precondition for success in pre-court negotiations. Also, some degree of institutional protection, especially the possibility of a stay of enforcement, for the negotiations was considered a factor that enhances voluntary settlements. It was also pointed out that creditor passivity may be a serious obstacle in voluntary settlements and it should be specifically regulated.

In the following we will present recommendations for consumer insolvency regulations to the Member States and future Member States. As the Member States will be drafting their laws in the near future, we hope that they will take into consideration these general principles which can be summarized from the already existing laws; rehabilitation, earned start through a payment plan, access to insolvency proceedings without prohibitive costs, availability of counselling and a preference for out-of-court or pre-court procedures.

III.B.2 Principles

We support the principles formulated in INSOL 2001 by leading world insolvency lawyers.²⁶⁰ In the following, we give our recommendations, which follow from the review of European consumer insolvency laws. They are given in a shorter and more precise form but the underlying concern is the same.

²⁶⁰ See subchapter I.A.3.c)

III.B.2.a) First Principle: Consumer Insolvency Law

All European Union Member States are economically advanced countries. In such countries, credit, including consumer credit and financing of small enterprises and self-employed persons, is an important and productive part of the economy. The new Member States, which access the Union in May 2004, may not yet have equally advanced financial markets but the speed of development in those countries is impressive and will be further enhanced by the accession to the Union.

In such advanced and fast developing credit markets, failure is also an unavoidable part of the economy. The costs of failure cannot be left to the debtor alone to bear. In practice all parties bear the costs: creditors who suffer losses and the society that is responsible for social security and the social costs engendered by marginalized people. If the debtor's burden is not alleviated when it gets unbearable, debtors run a high risk of becoming marginalized.

Therefore, even though we support preventive measures, consumer insolvency law should be enacted as a remedy in those cases in which the debt burden has become unbearable.

III.B.2.b) Second Principle: Discharge

Consumer insolvency law should give the debtor the possibility of a discharge from the debt burden. The discharge may be, in principle, partial so that the debtor is required to pay part of the total debt. The payment obligation has to be individually adjusted to the debtor's means.

Discharge of the total debt should be allowed in cases of hardship.

The discharge should, as far as possible, cover all the debtor's debts. Exceptions for taxes, fines, damages are not recommended. Other social policies to deal with these legitimate social concerns should be developed. A priority for alimonies to the debtor's children is, however, recognised in many Member States.

Furthermore, unknown debts, that is to say, debt not claimed by the creditor nor identified by the debtor, should be included.

Access to consumer insolvency law should be as open as possible. The denial of access should be used in cases of fraud and other serious misconduct, as the Member States find necessary.

III.B.2.c) Third Principle: Preference for Informal and Out-of-court Settlements

Debt problems should be tackled as early as possible. There should be a variety of remedies available for the debtor. The early



approach is also preferable for the creditors because it usually gives a better outcome than formal consumer insolvency proceedings.

Consumer insolvency law should also enhance a preference for less formal solutions. While the preference for out-of-court settlements can be observed in almost all Member States, the concrete laws differ considerably on this point. Therefore we want to indicate in the following only some features that, according to our observations, enhance out-of-court settlements.

Most importantly, debtors must have access to adequate legal aid or debt counselling to be able to benefit from out-of-court procedures.

Some degree of court supervision or the possibility of seeking support from the court facilitates out-of-court settlements. If negotiations for a settlement can be, for example, backed by a court-imposed stay of enforcement, the chances of a settlement improve.

Since settlements have the legal form of a contract, creditor resistance and passivity hamper such settlements. Therefore, specific measures for these situations should be considered. If creditor passivity can be assumed as acceptance of the settlement, the feasibility of settlements is improved considerably. Another approach might be that creditors are required to give reasons for their non-acceptance of a settlement and if their opposition is deemed unreasonable, they will bear the costs of court proceedings.

III.B.2.d) Fourth Principle: Court Procedure

If voluntary settlement is not reached, then consumer insolvency proceedings should be a possibility, leading to a discharge in the court. The legal safeguards for creditors and debtors should be as good as those in traditional bankruptcy and insolvency laws. The procedures can be simplified.

III.B.2.e) Fifth Principle: Consideration for Guarantors

People providing personal guarantees for the debtor's loan or who have given their property as a collateral for the debtor's loan, are not included in the consumer insolvency procedure in any Member State. Notwithstanding the consumer insolvency procedure, the creditor may collect the outstanding debt from such guarantors.

This is a major problem in many countries. It may lead to the overindebtedness of the guarantor. Because the loan matures, the guarantor is usually obliged to pay it at once, leading to his overindebtedness even in cases in which he could pay it in the long



run. The guarantors are usually family members, sometimes children who have scarcely reached adulthood or elderly parents, or other close persons. Therefore, the suffering in these cases cannot be measured in monetary terms only.

A satisfactory solution to this problem has not yet been devised. We urge all Member States to consider this problem very seriously when consumer insolvency laws are enacted and laws on personal guarantees are reformed.

III.B.2.f) Sixth Principle: Protection of Assets and Income

The consumer insolvency process should respect the right to a decent living standard for the debtor and his family. This includes the protection of assets and the right to income.

III.B.2.f)(1) Assets

The protection of assets should cover normal household items, furniture and home electronics. While luxury goods cannot be protected, it is usually not economically rational or reasonable to require that families give up their home computers or videos. In particular, it has to be remembered that children are not liable for their parent's debts and their assets and income cannot be seized.

The protection of assets also includes protection of tools required for gainful employment.

There is no unanimous policy about cars in the insolvency schemes. If a car is a tool for trade, it is usually protected. Other situations, such as when the car is needed to go to work, take children to care, or the debtor lives in a place with no public transport etc., should be taken into consideration.

We cannot recommend specific protection of homeowners to enable them to keep their homes. There are different housing policies in the different Member States, favouring either home owning or renting. Therefore the need for protection of home owning in consumer insolvency law also varies. The regulation of home protection is also difficult because the rights of secured creditors who have the home as collateral have to be protected as well. We do point out, however, that those countries that have homeowner protection in their consumer insolvency laws, such as Finland and France, are very satisfied with these regulations.

A rented home should as a rule be protected so that the debtor and the family may not be evicted for pre-procedure default in payment of rents after the opening of consumer insolvency proceedings.

III.B.2.f)(2) Income

There is a tendency to require that the debtor and the family live close to subsistence minimum during a payment plan. This approach should be reconsidered. It is not economically productive to require that people, who are capable of productive work, work for their creditors only.

The necessary living costs during the payment plan should be calculated in such a way that they leave some margin for changes in the living conditions. Progressive regulation of the payments above the minimum living standard is also a possible way of regulating the situation.

III.B.2.f)(3) Regulation

The protection of debtor's assets and income is often regulated through reference to the law of debt enforcement. These laws, however, have been enacted with the creditor's point of view in mind and tend to be old-fashioned. A separate regulation for the consumer insolvency law should be considered.

III.B.2.g) Seventh Principle: Reasonable Time Frame

It is a common European policy to require that debtors pay part of their debts according to a payment plan. This requirement is well founded and reasonable. However, the length of the plan needs further discussion both from the point of view of what is reasonable and from the point of view what is economically efficient.

The most common duration of a payment plan in Europe is five years. Debt counsellors often point out that this is a long time and psychologically very demanding for most debtors. Furthermore, before filing for bankruptcy most debtors will already have been living under considerable pressure for some considerable time. Five years is also a long time because a number of changes in family living conditions can take place during those years. Most insolvent debtors are in the 30-45 age group. At that age and stage, over any five year period, families are founded or broken, people get ill or recover, children are born, child care is organised, children become teenagers and need bicycles and other expensive tools, families move, change jobs and lose jobs etc. Considering all these possible changes, five years is a long period in terms of planning family finances.

Our recommendation is that three years should be the regular duration of a payment plan. It is psychologically realistic and there would be very little need to modify the plans. *Denmark*, where three-year plans were used, had no need for plan modification.

Since the five-year plan seems to be the European norm, conditions and procedures for plan modification need to be carefully considered. Debtors have to be able to seek alleviation of the payment obligation if they become ill or are laid off. Room to accommodate normal changes in family life has to be allowed when the plans are drawn up. And finally, there has to be some regulation of situations in which the debtor experiences considerable improvement in his financial situation.

III.B.2.h) Eighth Principle: Non-discrimination

The discharge should give the debtor full access to financial activity, including access to credit.

A clear statement on non-discrimination should be included in all consumer insolvency laws. This prohibition should cover discrimination, for example, in the labour market, in membership of organisations and in access to housing.

Special regulation of registration of credit information is required. Completed payment plans should be eliminated from registers.

III.B.2.i) Ninth Principle: Availability of Counselling and Legal Aid

Both out-of-court settlements and court procedures do not work without professional assistance. The debtor should have the right to a legal counsellor or, in less complicated cases, to the assistance of a professional debt counsellor. The role of the debtor's counsellor should be kept separate from the trustee who takes care of the debtor's estate and prepares the plan proposal. In any one case, these duties should be performed by different people.

III.B.3 Recommendations

III.B.3.a) Mutual Recognition and Minimum Standards

Consumer overindebtedness is a serious impediment to the free movement of persons among the Member States. The interests of the internal market have already been taken into account in the recovery of debts across the borders by the Council Regulation on Jurisdiction and Enforcement of Judgements (2000). Also the cross-border effects of business insolvencies have been recognized in the Council Regulation on Insolvency Proceedings (2000) (see above I.A.2).

The Insolvency Regulation is somewhat illogically applied to consumer insolvency proceedings filed in certain Member States, but not to those filed in some others. The present state of affairs is clearly not satisfactory.

From a practical point of view, the most feasible way to remedy the situation would be to include all consumer insolvencies under the Insolvency Regulation. The Insolvency Regulation, however, has not been carefully examined from the point of view of a consumer debtor. Our brief review suggests that there should not be any fundamental problems in the application of the Regulation to consumer insolvencies. We suggest, however, that a review of the Regulation be carried out.

We recommend, however, that the functional approach of the Regulation be reconsidered. The Regulation focuses on liquidation proceedings. This is hardly suitable for consumer insolvency proceedings which aim at rehabilitation of the debtor. Nowadays, liquidation is not even an appropriate way to describe the functions of business insolvency proceedings which include the goal of reorganization of the company. The functional approach is important for the interpretation of the Regulation. Thus, if the Regulation is applied also to consumer insolvency proceedings, there is the danger that the interpretation will be guided too much by the interests of the business bankruptcies if the functional approach is not changed.

Consumer overindebtedness has effects that cross borders and, in the worst case, consumer overindebtedness may be a serious obstacle to the movement of persons and services in the internal market.

We do not, however, recommend a Community Regulation on consumer insolvency legislation. We think that the cross-border effects are best handled by a Regulation on the jurisdiction, recognition and enforcement of consumer insolvencies in other Member States.

The main reason for not proposing a common Regulation is that there are still divergent opinions about what is reasonable in this context in different Member States. Many countries have developed their legal schemes, and information about their operation is accumulated all the time. Most countries are satisfied with the basic structure of their consumer insolvency laws and will soon be reviewing their laws. It is impossible to say at the moment that one system is better than the other. Therefore there is no basis for any kind of recommendation on harmonisation. Also the subsidiarity principle is an argument in favour of domestic regulation.

We do, however, recommend that the European Union consider an active policy regarding consumer insolvency. Research and exchange of information should be encouraged. Also the European Union recommendation to Member States to enact their own con-



sumer insolvency laws should be given. Such a recommendation could include general guidelines along the lines we have suggested above as principles.

III.B.3.b) Professional and Independent Debt Counselling

Money advice has its roots in social work in general. It is generally acknowledged today that financial counselling requires specialisation and that professional debt counsellors need many tools in order to be able to help their clients. In some Member States, specialised training courses are offered where counsellors can be educated to a professional level. In some countries, this work is exclusively provided by the public sector and charities, while in other Member States, debt counselling is offered on a commercial basis as well. It is very important that this new profession is developed to the highest standards of professionalism.

III.B.3.b)(1) Tools

Information and advice is given by almost every debt counsellor. For many clients, it is enough that they get information about what their rights are, how they have to respond to a summons of a creditor or whether the loan they have contracted is in accordance with the law.

It is also important that the counsellor has the necessary knowledge of other social services that are available and s/he can refer the debtor to the appropriate authorities, if needed.

A next step in debt counselling is advising consumers how to manage their financial affairs in a more efficient way. In this so called *budget advice* the debt counsellor intensifies his contact with the client, and the latter is encouraged to inform the former about his total income and outgoings. The counsellor supports the client in a double way: by advising on maximising income and minimising spending. Nowadays, technological developments offer many possibilities for professional debt counselling. Computer programmes have been developed in several European countries to standardise budgeting, money and legal advice.

While budgeting restricts itself to the relationship between counsellor and client, the next step may be to contact a creditor. Often counsellors assist the debtor in *bargaining* an out-of-court debt rescheduling arrangement with individual creditors.

In most European countries, consumer insolvency procedures in court are so complicated that the assistance of a lawyer would be recommended. In practice, however, there is a tendency to use debt counsellors as para-legal counsellors in insolvency proceedings. The debtor should also have a legal representative when a

creditor has started court proceedings. In practice, however, uncontested payment claims are usually processed without a lawyer. In both these situations, debt counsellors may to some extent play the role of para-legal advisers. That is, when the claims are not contested and the insolvency case does not involve complicated legal issues (such as mortgages, personal guarantors or co-debtors etc.). However, the debtor should always have access to legal representation when the circumstances warrant it, and debt counsellors should be able to advise the debtor when and how legal representation is needed.

The help required is particularly intensive where the debtor has more than one creditor. In such circumstances, the need for the drafting and concluding of a *debt settlement* with all creditors is important.

In the *Netherlands*, the Municipal Credit Bank (MCB) provides social loans as a way of debt settlement. The MCB bargains with all the creditors for a certain percentage of their claim and pays them off at once, via a loan to the consumer. Afterwards, the latter must repay the loan -at a modest interest rate- to the MCB, which has become the consumer's sole creditor.

III.B.3.b)(2) Specialisation

Debt counsellors must have knowledge of the financial, legal and social aspects of debts and overindebtedness. A counsellor should have insight into how financial markets work; how banks operate; what the debt enforcement strategies of mail-order houses are and what the disconnection policies of utilities are. Creditors have a material interest at stake and operate both aggressively and diligently to make sure that they get their money back. Especially in the case of consumers with multiple debts, counsellors have to defend their clients on several fronts. Moreover, they must be able to do basic accounting and have an understanding of welfare law. They must handle computerised advice and assistance programmes; they must be aware of key areas of debtor-creditor law and must also have insight into the ways creditors operate.

Specialisation is the key word for debt counsellors. They must be knowledgeable in household economics, they must develop bargaining skills and they must possess the necessary social skills to understand the problems of their clients. Increasingly, detailed legal knowledge, going beyond insolvency law, must become a part of their professional skills.

III.B.3.b)(3) Independence

Independence creates the basis for the establishment of trust. Independence vis à vis the creditors, and also vis à vis the State. It is also essential for their acceptance by the credit community that debt counsellors do not present themselves as the advocates of their clients and operate from an antagonistic point of view. In cases of a debtor's incapacity to pay, there are normally no distinctly opposed interests with respect to the joint creditors that need to be fought out in adversarial procedures. Debt counsellors should do their job in accordance with the principles of distance and objectivity.

It is desirable that debt counsellors develop generally accepted standards for their profession. Principles should be adopted on issues such as: how the ability to pay is determined, how much supervision of the debtor is needed, etc. These standards should be discussed with creditor umbrella organisations.

III.B.3.b)(4) Funding

We believe that all parties benefiting from the work of the debt counsellor should be asked to contribute a reasonable share of the costs. From this it follows that the debtor should pay a limited amount. There are strong arguments for financial support from national and local governments. Undoubtedly, the public interest is served by a professional debt counselling. Investments will be necessary to set up a network of debt counsellors with nation-wide coverage. Plan administrators or trustees must also be properly equipped to fulfil their legal duties.

We have no reservations about contributions from creditors. Their interests are also protected, as each creditor is prevented from trying to get paid at the expense of other creditors ('rob Peter to pay Paul'). Moreover, the counsellor performs monitoring role, which creditors would otherwise have to conduct themselves. From the viewpoint of the bank, the activities of the counsellor are costs like those of a debt collector.