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Responsible lending

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Summary: The following pages address the principle of responsible lending by providing a brief overview of the European Union's efforts to implement this principle in the Member States, paying special attention to lenders' duty to assess the creditworthiness and the consequences that failure to fulfil this duty should entail.

I. INTRODUCTION

The European Union incorporated the responsible lending programme into legislation, in an attempt to tackle the high levels of indebtedness resulting from the expansion in access to credit and new credit products and lending practices. It did so first, and rather timidly, into Directive 2008/48/EC of 23 April 2008 on Consumer Credit [1], and then more forcefully into Directive 2014/17/EC of 28 February 2014 on Credit Agreements for Consumers Relating to Residential Immovable Property [2]. The aim was to ensure that professional lenders took consumer needs and interests into account throughout the entire duration of the credit agreement, which entailed both the need to enable consumers to make maximum savings (e.g. via early repayment without penalty) and to prevent borrowers from succumbing to the temptation to commit themselves to

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1 OJ L 133, of 22.05.2008.

2 OJ L 60, of 28.02.2014.

risky loans agreements. The expression "responsible lending" is generally associated with good practices in the granting of credit (unfair practices in credit card approval and subprime mortgages would be clear examples of irresponsible practices to be tackled) and with the measures proposed to prevent over-indebtedness: e.g. transparency in the marketing of loans, creditworthiness assessment and the granting of a right of withdrawal. However, it also covers creditors' obligation to show reasonable forbearance when claiming repayment, for example, by limiting default interest, preventing the abuse of acceleration clauses and seeking to avoid foreclosure actions being carried out before attempts have been made to negotiate with debtors. It also entails implementing policies to improve consumers' financial education and, last but by no means least, involves addressing institutions' internal structural problems such as incentive policies promoting the misleading marketing of credit products; this would also affect intermediaries to a large extent and would apply to the remuneration linked to transactions concluded, and the sale of credit cards and insurance policies associated with loans, for example [3].

The pages that follow aim to provide a brief overview of the European Union's efforts to implement the responsible lending policy in Member States, paying special attention to lenders' duty to assess the risk of borrower default and the consequences that failure to fulfil this duty should entail.

II. THE WEAKNESS OF THE RESPONSIBLE LENDING PROGRAMME IN DIRECTIVE 2008/48 ON CONSUMER CREDIT

The revision of Directive 1987/102 on Consumer Credit first

[3] See Udo Reifner, "European Coalition for Responsible Credit — Principles of Responsible Credit", in Christian Twigg-Flessner *et al.* (eds.), *The Yearbook of Consumer Law 2008*, Aldershot, Ashgate, 2007, pp. 419-427; Yeşim M., Atamer "Duty of Responsible Lending: Should the European Union Take Action", in Stefan Grundmann — Yeşim M. Atamer (eds.), *Financial Services, Financial Crisis and General European Contract Law*, Kluwer, the Netherlands, 2011, pp. 179-202; Iain Ramsay, "Regulation of consumer credit", in Geraint Howells *et al.* (eds.), *Handbook of Research on International Consumer Law*, Elgar, Cheltenham, [pp. 366-408], pp. 394 ff.

materialised in a 2002 Proposal [4], the aims of which included the need to incorporate the idea of responsible lending, that is, the need for lenders to observe prudential supervision or management rules. Examples of this were the provisions concerning measures to prevent excessive indebtedness and others obliging lenders to consult central databases in order to improve the quality of lending and reducing the risk of consumers falling victim to unbalanced agreements, which they were incapable of fulfilling, and which resulted in financial exclusion and costly social interventions on the part of Member States. The principle of responsible lending also required consumers seeking credit to exercise the same prudence and to respect their contractual obligations [5].

1. Measures to reduce the risk of unbalanced agreements

The principle of responsible lending materialised in art. 9 of the Proposal, which made lenders responsible for ascertaining consumers' ability to repay before granting loans. This could require cooperation on the part of consumers, and the provision therefore had to be completed by art. 6, which established reciprocal duties of information (consumers as to their financial situation; lenders as to the description of the product they offered and its advantages and drawbacks) and a duty to provide advice which entailed choosing the most suitable loan for applicants' circumstances. Art. 9 also had to be viewed in relation to art. 8, which established mandatory consultation of a central database that included a record of repayment defaults, although it could also include a record of credit and surety agreements.

A consumer protection instrument that went beyond lenders' pre-contractual duties of information was thus adopted to encourage responsible practices in granting credit [6]. However, the duties of information did

[4] 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 [Brussels, 11.09.2002 (COM (2002) 443 final].

[5] Proposal for a Directive on consumer credit 2002, p. 16 (commentary on art. 9).

[6] Iain Ramsay, "From Truth in Lending to Responsible Lending", in Geraint Howells *et al.* (eds.), *Information Rights and Obligations*, Ashgate, Aldershot, 2005, pp. 47-65.

not disappear; on the contrary, they increased, perhaps to the detriment of other essential measures such as determining EU-level criteria for defining maximum interest rates and what constitutes usury [7].

2. Creditworthiness assessment: a duty of care

Assessing the ability to repay was an obligation of means and, consequently, consumers' failure to discharge their obligations should not automatically entail lender liability; rather, the facts of every particular case had to be examined by the legal authorities [8]. What is important here is that the Commission expressly stressed the relationship between concluding credit agreements and the prior assessment of debtors' ability to repay, as this would suggest that when the prognosis was not favourable to granting a loan (the loan requested or any other), the lender should not conclude the credit agreement, and to do so would imply a lack of care that should have civil consequences. In the model provided by Belgian legislation [9] — and undoubtedly also Swiss [10], although the latter was not specifically mentioned — this was illustrated by the possibility of lenders forfeiting the interest and costs and consumers' maintaining repayment of the total amount of the loan in instalments (art. 31(2)). All this was the measure of what the Commission considered a penalty that was effective, proportionate and constituted a deterrent (art. 31(1)), although administrative penalties were not ruled out [11]. In a subsequent and detailed Opinion the

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7 One of the measures called for by the European Economic and Social Committee (Eesc) in Opinion (OJ C 234 of 30.09.2003), sections 2.2.4 ff. The Eesc also criticised the Proposal's general philosophy, according to which "consumer protection" is the same as "consumer information" (e.g., sections 2.4.3, 2.4.5).

8 Proposal for a Directive on consumer credit 2002, pp. 15-16 (commentary on art. 9).

9 For details, Peter Rott — Evelyn Terryn — Christian Twigg-Flesner, "Kreditwürdigkeitsprüfung: Verbraucherschultzverhinderung durch Zuweisung zum Öffentlichen Recht",*Verbraucher und Recht*, 2011, 5, [pp. 163-169], p. 164.

10 For details, Atamer, "Duty…", in Grundmann — Atamer (dirs.), *Financial Services…*, pp. 192-193.

11 Proposal for a Directive on consumer credit 2002, p. 28 (commentary on art. 31): "Possibilities include a loss of interest and/or penalties as well as the withdrawal of their licence."

European Economic and Social Committee (EESC) examined the question of whether the Proposal should clearly set out the consequences of failing to consult or take into account database information about borrowers, coming down decisively in favour of the view that the penalties for lenders that failed to respect the provisions concerning responsible lending would entail the loss of the right to the interest and costs [12].

3. A different way of looking at the issue

These levels of stringency were lowered at the first reading of the Commission's Proposal in the European Parliament, however.[13]The Proposal was interpreted as making access to credit tougher, with the risk of social exclusion that this could entail for innumerable members of the public. It was warned that the Commission was not approaching the question in the right way, because over-indebtedness is normally the consequence of either a series of unexpected life events (unemployment, divorce and illness) or of debtors' own illicit practices [14]. For this reason, although the Parliament did not delete the obligation to assess creditworthiness, it did delete art. 9 as drafted by the Commission, aiming to make it clear that responsibility extended to the duty to supply information and also to highlight the idea that both lending and borrowing should be responsible. The duty to provide advice on the most suitable loan for consumers' financial situations was also deleted [15]. The Committee on Economic and Monetary Affairs had maintained that the obligation to provide advice could only be met by carrying out detailed investigations into consumers' personal affairs and complained that this would not only mean an intolerable intrusion into their private lives but would also be

[12] OJ C 234 of 30.09.2003, sections 3.4.1, 3.12.2.

[13] Committee on Legal Affairs and the Internal Market (Rapporteur: Joachim Wuermeling), Final A5-0224/2004: Second Report on the Proposal for a European Council Directive of 2.04.2004.

[14] Second Report (Explanatory Statement), p. 83, p. 84.

[15] Second Report, amendment 17, deleting Recital 15 (pp. 14-15); amendment 65, which affected arts. 6 and 9 (pp. 34-37).

unviable in many cases (e.g. offers of distance loans) [16]. In its opinion, it was also pointless to introduce the principle that lenders could not conclude credit agreements unless they were convinced that consumers or guarantors could meet their obligations; lenders by definition have an interest in carefully assessing debtors' ability to repay by virtue of the criteria of sound and prudent management, and the technical arrangements for this assessment form part of the free exercise of business activity [17]. The Committee also considered that evaluating lender behaviour when a guarantor was required raised problems because it was unclear whether this indicated that the lender was convinced that the borrower would not repay the loan and should therefore also be understood to be acting irresponsibly. It was also felt that any negative effects of adopting this regulation would be projected onto lenders that were unable to recover their loans for reasons beyond their control. Lastly, it was argued that the supply of credit would contract, which would clearly be to the detriment of consumers because no lender would run the risk of offering loans to consumers with a history of default [18].

The Parliament consequently understood that the principle of 'responsible lending' should be totally deleted, since it only contained a repetition of obvious contractual obligations and was therefore redundant and should not appear in a legal text [19]. It was also said that in practice lenders already acted to reduce risk by checking whether consumers or guarantors were in a position to meet their obligations [20]. On the other hand, the need for both consumers and lenders to behave prudently and respect their contractual obligations should be expressly stated [21]. In other words, while lenders prudence could be taken for granted (because it is in their interests to be sure of borrowers' ability to repay), the same could not be said of borrowers,

16 Second Report, amendment 17, deleting Recital 15 (p. 93).
17 Second Report, amendment 55, deleting Recital art. 9, p. 109.
18 Second Report, amendment 55, deleting Recital art. 9, p. 109.
19 Second Report, amendment 17, deleting Recital 15, p. 15.
20 Second Report, amendment 17, deleting Recital 15, p. 15.
21 Second Report, amendment 18, introducing new paragraph 15 *a* in the Explanatory Statement (p. 15).

whose behaviour was not above suspicions of recklessness. What should therefore be encouraged was responsible consumer borrowing, an aspect that the 2002 Proposal reflected only timidly [22].

4. A new solution in support of banks

These objections obliged the Commission to present a new text in 2005 [23], in which the principle of responsible lending was reduced to the duty to provide pre-contractual information and assess consumer creditworthiness on the basis of detailed data obtained from consumers themselves and, where appropriate (this was no longer mandatory), from consulting the relevant databases (art. 5(1)). In addition, the duty to propose the most suitable loan according to borrowers' needs in view of their financial positions, the risks, the advantages and disadvantages and the purpose of the loan, was deleted (art. 6 (3) 2002 Proposal) [24]. The new text instead introduced a lender duty to provide adequate explanations so that consumers could assess whether the proposed agreement suited their needs and financial position, in addition to the duty to clarify the meaning of the pre-contractual information and give details of the advantages and disadvantages associated with the proposed products if necessary (art. 5 (5) 2005 Proposal). *Mutatis mutandis*, these provisions would subsequently correspond to art. 5 (6) (adequate explanations; Recital 27), art. 8 (creditworthiness assessment; Recital 26) and art. 9 (database access).

5. The final outcome

Directive 2008/48 accepted that consumers were ultimately responsible for their decisions and did not include the prohition on granting

[22] Proposal for a Directive on consumer credit 2002, p. 16 (commentary on art. 9).

[23] Amended proposal for a Directive of the european parliament and of the council on credit agreements for consumers amending Council Directive 93/13/EC [Brussels, 23.11.2005, COM (2005) 483 final/2].

[24] Favouring this approach, Stefan Grundmann — Christian Hofmann, "EC Financial Services and Contract Law — Developments 2007—2010", *European Review of Contract Law*, 2010, 4, [pp. 467-484], p. 480.

credit if they turned out not to be creditworthy. On this basis, the adequate tailored explanations that lenders were obliged to give could not supplant consumers' wishes, as the latter were ultimately responsible for decisions to enter into contracts and to obtain the loans that they wanted. The Directive neither required the creation of a central default database nor even obliged lenders to consult any database at all [25]; it did not stipulate what information consumers had to provide [26], and did not rank the criteria lenders should use to decide on creditworthy applicants. In practice, positive credit assessments were frequently achieved thanks to the provision of extremely long repayment terms, and the risk of default served to increase the interest rate for borrowers who appeared less likely to repay their debts. The bursting of the housing bubble highlighted these and other practices, some of them dishonest, and showed that the duty to take due account of borrowers' needs had been systematically ignored in the field of mortgage credit.

III. GREATER PROTECTION FOR MORTGAGE CREDIT CONSUMERS IN DIRECTIVE 2014/17

Member States had until the end of May 2010 to transpose the Consumer Credit Directive (art. 27), but it was useful to examine responsibility in the granting of mortgage credit in more detail, bearing in mind the serious consequences of over-indebtedness in this market, both for consumers and the financial system as a whole [27]. So,

[25] For more detail, Federico Ferretti, "The Legal Framework of Consumer Credit Bureaus and Credit Scoring in the European Union: Pitfalls and Challenges — Over-indebtedness, Responsible Lending, Market Integration, and Fundamental Rights", *Suffolk University Law Review*, 2013, 46, [pp. 791-828], pp. 802-807.

[26] In contrast, amendment 65 on the reform of arts. 6 and 9, of the Committee on Legal Affairs and the Internal Market did provide for this, although the consumer was responsible for paying for the assessment supplying this information (Second Report, p. 38).

[27] Guido Comparato, "The Design of Consumer and Mortgage Credit Law in the European System", in Hans W. Micklitz — Irina Domurath (eds.), *Consumer*

while the first directive cited above had the clear function of expanding credit in the domestic market, the second, which was enacted after the housing crash, needed stricter requirements to tackle irresponsible banking practices [28].

1. The system's vulnerability

The financial crisis, and with it the avalanche of foreclosures in many European Union countries in which financing possibilities had been extended to enable people to purchase their own homes, revealed the system's vulnerability [29]. Banks encouraged fictitious valuations, granted very long mortgage repayment terms, were very flexible with interest rates and, above all, did not correctly assess borrowers' ability to repay, among other reasons because they were excessively confident that property prices would continue to rise. In addition, new mortgage and financial products and ancillary services to loans were invented, whose risks were not made clear to consumers. Moreover, credit institution staff was ignorant of the risks and supervision was inadequate. In Spain [30] credit intermediaries were not subject to control until 2009 [31], and the need to carry out borrower creditworthiness

Debt and Social Exclusion in Europe, Ashgate, Farham, 2015, [pp. 9-26], pp. 18-19.

28 Comparato, "The Design…", in Micklitz — Domurath (eds.), *Consumer*…, p. 15.

29 See the reports in Micklitz — Domurath (eds.), *Consumer Debt*…, pp. 29 ff; see also, EU Private Law Jean Monnet Working Papers, 2017, 1-8 (www.ub.edu/jeanmonnet_dretprivateuropeu/en/publicacions_en.html).

30 With regard to realities in Spain, underlining the impact of irresponsible lending and the lack of adequate control, Miriam Anderson — Simon Moreno, "The Spanish Crisis and The Mortgage Credit Directive: Few Changes in Sight", Anderson, Miriam — Arroyo Amayuelas, Esther (eds), *The Impact of the Mortgage Credit Directive in Europe*, Groningen, Europa Law Publishing, 2017, pp. 50 ff; Sergio Nasarre Aznar, "Malas prácticas bancarias en la actividad hipotecaria", *Revista Crítica de Derecho Inmobiliario*, 2014, 727, pp. 2665-2737; Fernando Zunzunegui, "Sobreendeudamiento y prácticas hipotecarias de las entidades bancarias", *Revista de Derecho Bancario y Bursátil*, 2013, 129, pp. 35-75.

31 Law 2/2009 of 31 March regulating consumer loans and mortgage credit agreements and intermediary services for concluding loan or credit agreements (BOE no. 79 of 1 April 2009).

checks was unregulated until levels of indebtedness reached vertiginous heights (2011) [32]. There was no regulation of insolvency proceedings by natural persons until very recently (2015) [33], clearly long after it was introduced in Italy, which was wrongly said to be the last country in Europe whose national legislature addressed the problem (in 2012) [34].

2. The lessons to be drawn from the financial crisis

Directive 2014/17 aimed to draw lessons from the financial crisis and eradicate irresponsible lending practices (Recitals 4, 5) on the basis of incorporating stricter provisions than the previous Directive (Recital 22). Following the White Paper on the integration of EU mortgage credit markets [35], the Commission launched a consultation on responsible lending and borrowing, which helped to define its profile more clearly [36]. The Proposal for a Directive was submitted in 2011 [37], the European Parliament issued its amendments report in 2012 [38] and the Proposal was approved shortly after, extensively retouched but without

[32] Essentially, Order EHA/2899/2011 of 28 October on transparency and customer protection in banking services (BOE no. 261 of 29.11.2011).

[33] Law 25/2015 of 8 July on the fresh start mechanism, reducing financial burdens and other social order measures (BOE no.180 of 29 July 2015).

[34] Roberta Montinaro, "The consumers' over-indebtedness under an Italian contract law perspective: The current status and the way ahead", *Europa e Diritto privato*, 2016, 4, [pp. 1215-1248], p. 1217.

[35] Brussels, 18.12.2007 (COM (20007) 807 final, pp. 7-9 on responsible lending and borrowing.

[36] See Public Consultation on Responsible Lending and Borrowing in the EU (Brussels, 15.06.2009): www.ec.europa.eu/internal_market/consultations/docs/2009/responsible_lending/consultation_en.pdf (last accessed: 17.04.2017). See also, Summary of Responses to the Public Consultation on Responsible Lending and Borrowing in the EU (Brussels, 30.11.2009), in www.ec.europa.eu/internal_market/finservicesretail/docs/credit/resp_lending/feedback_summary_en.pdf (last accessed: 17.04.2017).

[37] Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property [Brussels 31.2.2011, COM (2011) 142 final].

[38] I Report on the proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property (Rapporteurs: Antolín Sánchez Presedo/Kurt Lehner). Document PE469.842v04-00 of 11.10.2012.

major problems [39]. The EESC, which strongly advocated responsible lending, had called for some significant adjustments such as the regulation of usury or the incorporation of an adequate loan to value ratio [40], but these aspects ultimately failed to materialise.

3. How could consumers be protected?

The Directive incorporates *ex novo* rules disciplining lender conduct based on the requirement for adequate levels of knowledge and competence, imposing transparency on remuneration and regulating the requirements for the performance and establishment of credit intermediaries. With the aim of encouraging responsible borrowing, there is a new suggestion for improving consumers' financial education (arts. 6, 22 (7)); while this may turn out to be of dubious practical efficiency when the information is highly complex, it could at least help in making decisions related to managing household finances [41]. The regulation also enhances consumer protection by requiring new warnings to be included in advertising and more complete and tailored information (arts. 11, 13-14) together with adequate explanations (art. 16).

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[39] For the vicissitudes in its gestation, Frank L. Schäfer (2014), "Wohnimmobilienkreditrichtlinie. Geschichte und Umsetzung im Verbraucherdarlehensrecht", *Verbraucher und Recht*, 2014, 6, [pp. 207-216], pp. 207-212; Esther Arroyo Amayuelas, "Directiva 2014/17, sobre los contratos de crédito con consumidores para bienes inmuebles de uso residencial", *InDret*, 2017, 3, [pp. 1-45], esp. pp. 1-12.

[40] Opinion of the Eesc on the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property (OJ C 318 of 29.10.2011), sections 1.10 and 3.3.8 and 9.

[41] Regarding the measure's somewhat limited effects, in part as a consequence of the EU's lack of competence to put it into practice, Irina Domurath, "A Map of Responsible Lending and Responsible Borrowing in the EU and Suggestions for a Stronger Legal Framework to Prevent Over-Indebtedness of European Consumers", in Micklitz — Domurath (eds.), *Consumer Debt*... [pp. 155-175], pp. 163-164. Equally sceptical, Vanessa Mak, "The Myth of the 'Empowered Consumer': Lessons from Financial Literacy Studies", *Journal of European Consumer and Market Law*, 2012, 4, [pp. 254-263], pp. 258-259. On the subject of consumers' financial education, COM (2007) 808 final and Opinion of the Eesc (OJ C 318 of 29.10.2011).

3.1. Information, explanations and the provision of advice

As consumers often decide to take out loans on the basis of advertisements, it is essential for advertising to contain basic information such as the duration of the loan, the number of instalments and the price (at least the APR). If, on the other hand, advertising or pre-contractual information confronts consumers with an avalanche of mandatory statements that they are not always capable of understanding, rational decision-making becomes more difficult [42]. This problem was only partly solved by the precautions adopted to make the language used in the European Standardised Information Sheet (ESIS) less technical than the legal terms in the Directive (Recital 41).

As in the previous Directive 2008/48 (art. 5 (6)), Directive 2014/17 (art. 16) maintains the need to provide explanations that enable consumers to choose the most suitable credit products for their needs and financial situation, and, if necessary, to explain the pre-contractual information, the features of the proposed product, the services associated with it, the obligations undertaken and the risks in the event of default. There is of course no guarantee that consumers will abandon their decision to take out credit in spite of explanations of the adverse consequences of their decision; there appears to be an almost natural tendency to ignore what is complex, exaggerated optimism over future income, and a disregard for the possible setbacks that may arise during the long life of a loan (e.g. divorce, illness or job loss) [43]. However, it

[42] For a general critique of this model of consumer protection in the financial context, see Atamer, "Duty…", in Grundmann — Atamer (dirs.), *Financial Services*…, pp. 188-189; Johannes Köndgen, "Policy Responses to Credit Crises: Does the Law of Contract Provide an Answer?", in Grundmann — Atamer (eds.), *Financial Services*…, [pp. 35-59], pp. 47-49. Concerning Directive 2014/17, Benjamin Zapf, "Die Wohnimmobilienkreditrichtlinie 2014/17/EU — Am Ziel einer langen Reise?", *Zeitschrift für europäisches Privatrecht*, 2016, 3, [pp. 656-686], pp. 657-658, 664-675.

[43] Atamer, "Duty…", in Grundmann — Atamer (dirs.), *Financial*…, pp. 184-185; Domurath, "A Map…", in Micklitz — Domurath (eds.), *Consumer Debt*…, *p.* 160. With detail, Ramsay, "From Truth…", in Howells *et al.* (eds.), *Information Rights*…, pp. 52 ff. Regarding borrowers' imperfect reasoning in the context of subprime mortgages, see Oren Bar-Gill, "The Law, Economics and Psychology

would be said that such warnings could be redirected to the "advisory services" regulated in art. 22 (cfr. art. 22 (3) letter (a) Directive 2014/17). The White Paper had considered it highly desirable for consumers to be given "objective advice, which is based on their individual profile and commensurate with the complexity of the products and risks involved", so as to acquire the most suitable product for them, but it also recommended that credit institutions should not be under a legal obligation to offer this advice for fear that this would have negative repercussions on mortgage prices and limit the range of products available to consumers [44]. This is undoubtedly why Directive 2014/17 does not make this mandatory, either for credit institutions or for independent third parties. It is clear that if advice were provided by lenders (or tied intermediaries) these would only have to take into account their own range of products (art. 22 (3) *b)*) [45]. In reality, this would always be the case, as to assess borrowers' ability to repay, lenders would first have to establish which loan is in their best interests.

3.2. Cooling-off period/Right of Withdrawal

The cooling-off period (period of reflection, according to the Directive) and the right of withdrawal (art. 14 (6)) are signs of responsible borrowing, and the latter also appeared in Directive 2008/48 (art. 14).

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of Subprime Mortgage Contracts", *Cornell Law Review*, 2009, 94, [pp. 1073-1151], esp. 1119 ff.

[44] White Paper, p. 7. Agreeing, Zapf, "Die Wohnimmobilienkreditrichtlinie…", p. 680. Regarding the possible conflict of interests, see Public Consultation on Responsible Lending and Borrowing in the EU (Brussels, 15.06.2009), p. 8, pp. 13-14. Against converting lenders into consumer affairs managers, Andreas Piekenbrock, "Die geplante Umsetzung der Wohnimmobilienkreditvertragsrichtlinie", *Zeitschrift für das Privatrecht der Europäischen Union*, 2015, 1, [pp. 26-36], p. 35.

[45] This issue has been the object of detailed analysis in the UK. See Financial Services Authority, Mortgage Market Review: Distribution & Disclosure, Consultation Paper 10/28, Chapter 2; Financial Services Authority, Mortgage Market Review: Proposed Package of Reforms, Consultation Paper 11/31, December 2011, Sections 5.46-5.53, where it is explained that the general rule is that "an intermediary must always assess whether a mortgage is appropriate for the consumer based on the consumer's particular needs and circumstances" (section 5.52). Later, Mortgage Conduct of Business Rules 4.7A [advised sales] and 4.8A [execution-only sales].

The benefits of the right of withdrawal are more apparent than real, because consumers only seem to remember their right of withdrawal when they start to have repayment problems and the right has expired [46]. Moreover, it will not be exercised if the loan has already been invested in the purchase of property and/or the mortgage has been registered. In such scenarios, it falls to Member States to decide whether the right has lapsed (Recital 23). Neither does the cooling-off period seem to be very useful for preventing over-indebtedness if consumers can accept offers at any time during this period (art. 14 (6) *b)*. [47] Ensuring speedy access to the money is incompatible with the purpose of the measure, which is that consumers can seek advice before concluding credit agreements [48].

3.3. An understanding approach to borrowers

Directive 2014/17 introduces for the first time provisions on the reasonable forbearance that creditors must show to reduce the number of repossessions and/or alleviate the effects of falling into arrears and foreclosure (art. 28) [49]. The philosophy is that it is better to adjust the conditions of a loan than to terminate the credit agreement, and it is consequently necessary to make every effort to avoid early termination of loans if this could lead to the premature enforcement of the collateral. Furthermore, charges must be restricted to what is needed to cover the real cost of the default: administration expenses and interest for default. It would be fair if interest payable were equivalent to the cost of refinancing to the lender, but Directive 2014/17 allows

[46] Describing the experience in Germany, Rott "A plea for special treatment of financial services in unfair commercial practices law", *Journal of European Consumer and Market Law*, 2013, 2, [pp. 61-68], p. 66.

[47] It is so in Belgium (art. VII.127 (3) Code de Droit économique), the United Kingdom (Mortgage Conduct of Business Rules 6A.3.4 R (2) (b)), or Italy (art. 120-*novies* (3) Testo Unico Bancario).

[48] In contrast, see Zapf, "Die Wohnimmobilienkreditrichtlinie…", p. 681.

[49] See Commission Staff Working Paper "National measures and practices to avoid foreclosure procedures for residential mortgage loans" document accompanying the Proposal for a Directive on credit agreements relating to residential property, Brussels, 31.03.2011 (SEC (2011) 357 final).

higher default interest rates to be imposed in accordance with the limit provided by national legislatures [50]. It seems to have been precisely the experience in Spain that encouraged the European Parliament to introduce these and other measures into Directive 2014/17, especially the possibility for Member States to recognise the voluntary *datio in solutum* in order to discharge debts [51]. Shortly afterwards, the European Parliament itself drew attention to the shocking consequences of over-indebtedness and foreclosures in Spain and warned that adopting a voluntary code of conduct to alleviate the effects of the crisis would merit mistrust [52].

Among the measures adopted in Spain from 2011 to 2015 were increasing the minimum level of income that could be seized, debt relief/reduction, extending the repayment period, enabling fresh starts in the event of insolvency proceedings and accepting transfer of property in lieu of payment (*datio in solutum*), sometimes together with allowing debtors to rent back the property they had transferred. Legislation was (and still is) accompanied by a good number of ECJ rulings on the unfairness of some mortgage loan terms, a matter on which Directive 2014/17 is silent. However, it should be noted that these measures have been suboptimal in Spain, since the new laws adopted have been highly restrictive and have failed to benefit a significant number of people.

Where default interest rates are concerned, art. 28 (2) and (3) Directive 2014/17 provide the opportunity for the legal setting of lower default interest rates than those established in national law for mortgage credits, as well as extending the rule to other types of loan. However, art. 25 of the Spanish Act 5/2019 and art. 114.3 of the *Ley Hipotecaria* (LH)

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50 See Reifner, "European Coalition…", in Twigg-Flesner *et al.* (eds.), *The Yearbook*…, p. 424.

51 Iain Ramsay, "Two Cheers for Europe: Austerity, Mortgage Foreclosures and Personal Insolvency", in Micklitz — Domurath (eds.), *Consumer Debt*…, [pp. 189-227], pp. 217.

52 European Parliament Resolution "Mortgage legislation and risky financial instruments in the EU: the case of Spain" of 8 October 2015 (P8_TA-Prov(2015)0347). Previously, Human Rights Watch, "Shattered Dreams: Impact of Spain's Housing Crisis on Vulnerable Groups", May 2014 (www.hrw.org/report/2014/05/27/shattered-dreams/impact-spains-housing-crisis-vulnerable-groups).

transposing the Directive [53], establishes that these should be three points above the agreed ordinary interest rate. The legislature trys to prevent unfair terms and ensure the necessary economic and financial balance between the parties, but it is against EU legislation that the regulation is mandatory and does not admit exceptions, even when these would be to the benefit of consumers [54].

IV. THE PARTICULAR DUTY TO ASSSESS CONSUMER CREDITWORTHINESS

Long before any EU directives were enacted, some national legal systems already prohibited lending to prospective borrowers without positive credit assessments (e.g. Belgium [55], the Netherlands [56]); while others only imposed a duty on lenders to warn of the risk of over-indebtedness, doubtlessly with the aim of ensuring that they refused to approve loans that exceeded borrowers' ability to repay, but without making this an obligation. In France this rule was developed through case law and as a rule only applied to poorly informed consumers [57]. In Germany, there was no such restriction and borrowers were held

[53] Act 5/2019, of 15 March, *reguladora de los contratos de crédito inmobiliario* (BOE no 65, of 16.03.2019).

[54] On the incorrectness of that transposition, see Esther Arroyo Amayuelas, "Límites a los intereses moratorios", in Anderson, Miriam — Arroyo Amayuelas, Esther — Aparicio, Adauca (eds), *Cuestiones hipotecarias e instrumentos de prevision. El impacto de la jurisprudencia de la Unión Europea*, Barcelona, Marcial Pons, 2021 (forthcoming).

[55] Rott —Terryn —Twigg-Flesner, "Kreditwürdigkeitsprüfung…", p. 164.

[56] Art. 4:34 Act of 28 September 2006, on rules regarding the financial markets and their supervision (Act on Financial Supervision). On this subject, Vanessa Mak, "What is Responsible Lending? The EU Consumer Mortgage Credit Directive in the UK and the Netherlands", *Journal of Consumer Policy*, 2015, 38, [pp. 411-430], pp. 422-423; Jurgen Braspenning, "Mortgage credit in the Netherlands", Journal of European Consumer and Market Law, 2017, 4, [pp. 180-184], pp. 181-182.

[57] Rott —Terryn —Twigg-Flesner, "Kreditwürdigkeitsprüfung…", p. 164; Köndgen, "Policy…", in Grundmann — Atamer (eds.), *Financial Services…*, p. 52. In detail, Jörg Benedict, "Responsible Lending. — Das europäische Vertragsrecht zwischen caveat emptor und caveat creditor!", *Zeitschrift für europäisches Privatrecht*, 2008, 2, [pp. 394-410], pp. 408 ff.

responsible for their own actions.[58]The duty to assess creditworthiness was recognised for the first time in Directive 2008/48 (art. 8, Recital 26), although it is art. 4 (17) Directive 2014/17 that explains what this consists of: "the evaluation of the prospect for the debt obligation resulting from the credit agreement to be met" [59].

However, Directive 2008/48 did not oblige lenders to refuse credit if borrowers were not sufficiently creditworthy. To some authors this could clearly be deduced from Recital 26 [60], but the Directive had generally been interpreted to mean that lenders only have the duty to warn of the risk and should leave borrowers to decide whether to take out the loan [61]. The fact that some Member States had also made

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58 See Christian Hofmann, "Die Pflicht zur Bewertung der kreditwürdigkeit", *Neue Juristische Wochenschrift*, 2010, 25 [pp. 1782-1786], pp. 1783-1784, fn. 2, 12.

59 For comparisons between the two directives, see Olha O. Cherednychenko — Jesse M. Meindertsma, "Irresponsible Lending in the Post-Crisis Era: Is the EU Consumer Credit Directive Fit for Its Purpose?", *Journal of Consumer Policy*, 2019, 42, [pp. 483—519], pp. 500-502. On the current need to review certain provisions of the Directive 2008/48, particularly on the creditworthiness assessment, see EU Comission, "Report from the Commission to the European Parliament and the Council on the Implementation of Directive 2008/48/EC on Credit Agreements for Consumers", COM(2020) 963 final, Brussels, 5.11.2020, pp. 2-3, 6.

60 Thus, in Italy, Giovanni de Cristofaro, "La nuova disciplina comunitaria del crédito al consumo: La direttiva 2008/48/CE e l'armonizzacione «completa» delle disposizioni nazionali concernenti «taluni aspetti» dei «contratti di credito ai consumatori»", *Rivista di Diritto Civile*, 2008, 3, [pp. 255-302], p. 274. Qualifying this idea, Matteo M. Francisetti Brolin, "L'art. 124-*bis* del TUB e gli incerti riflessi civilistici del c.d. «merito creditizio» nel credito al consumo: dalla *culpa in contrahendo* al vizi del volere", *Contratto e Impresa/Europa*, 2014, 2, [pp. 541-580], pp. 559-560. See ECJ C-449/13, *CA Consumer Finance SA* (§35); ECJ C-58/18 of 6.06.2019 Michel Schyns (§45): "Recital 26 of that directive reiterates the objective of making creditors accountable and deterring them from engaging in irresponsible lending."

61 Stefan Grundmann — Christian Hofmann, "EC Financial Services and Contract Law — Developments 2007—2010", *European Review of Contract Law*, 2010, 4, [pp. 467-484], p. 481; Peter Rott, "Consumer Credit" in H. W. Micklitz *et al*., *Understanding EU Consumer Law*, Antwerp, Intersentia, 2009, [pp. 177-213], p. 199; Vanessa Mak — Jurgen Braspenning, "*Errare humanum est:* Financial Literacy in European Consumer Credit Law", *Journal of Consumer Policy*, 2012, 3, [pp. 307-332], p. 327.

provision for this outcome [62], doubtlessly accounted for the fact that shortly after Directive 2008/48 was enacted the European parliament felt obliged to recommend that neither consumer nor mortgage credit should be granted to consumers whose creditworthiness had not been established or had not provided suitable collateral [63]. In fact, this would be later mentioned in ECJ judgement C-449/13 of 18.12.2014 *CA Consumer Finance* (§§35, 43) and C-679/18 of 5.03.2020, *OPR-Finance s.r.o* (§20), which stated that this obligation (assessing creditworthiness) aimed to make lenders responsible and avoid loans being granted to uncreditworthy consumers. On the other hand, acording to the ECJ judgement C-58/18 of 6.06.2019, *Michel Schyns* (§45-49) it is perfectly possible a national rule establishing an obligation on the creditor to refrain from concluding a credit agreement if he establishes a lack of creditworthiness on the part of the consumer.

Europe did not previously oblige lenders to carry out credit checks before granting mortgages because Directive 2008/48 did not refer to loans of this type, but it should be assumed that individual assessments were regarded as part of standard banking practice in Member States before they became mandatory. However, it has become clear that there were a number of incentives for not actually carrying these out: on the one hand, loans could be approved more quickly, thus saving costs and attracting new clients; on the other hand, salaries were linked to the number of loans approved. Furthermore, risk was transferred

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[62] See in Germany, Hofmann, «Die Pflicht…», pp. 1785-1786; in Austria, §7 (2) Dakräg (Darlehens-und Kreditrechts-Änderungsgesetz): "[W]enn diese Prüfung erhebliche Zweifel an der Fähigkeit des Verbrauchers ergibt, seine Pflichten aus dem Kreditvertrag vollständig zu erfüllen, hat der Kreditgeber den Verbraucher auf diese Bedenken gegen dessen Kreditwürdigkeit hinzuweisen". *Vid*. Brigitta Zöchling-Jud, §7 VKrG, in Christiane Wendehorst — Brigitta Zöchling-Jud, *Verbraucherkreditrecht,* Wien, Manz, 2010, Rn. 28-29. In general, Köndgen, "Policy…", in Grundmann — Atamer (eds.), *Financial Services…*, pp. 51-52, with references to other legal systems. In Spain it had been argued that consumers could only annul agreements in exceptional cases, when the credit institution had wilfully concealed essential information about the debtor's ability to repay. See Luis De la Peña — Juan López-Frías, "Crédito responsable: un nuevo concepto en nuestro ordenamiento", *Revista de Derecho Bancario y Bursátil*, 2013,130, [pp. 47-78], pp. 68-69, 77.

[63] Opinion of the Committee on Economic and Monetary Affairs (8.6.2012).

to third parties (through securitization, sale of the loan portfolio, collateral or mortgage to third parties) and there was the certainty that the property could be sold [64]. This laxity led to an increase in the costs linked to claims and enormous harm, not only to borrowers themselves but also to third party guarantors and the ultimate purchasers of the loan, and finally, to the need to bail out the banks.

This is certainly why Directive 2014/17 imposes the obligation to carry out "thorough" creditworthiness assessments (art. 18 (1)), regulating this issue in some detail in arts. 18-20. The assessment must be carried out before the credit agreement is concluded (Recital 55); in fact, before lenders provide tailored information, given that they need to take into account which loan best meets borrowers' needs (art. 14 (1) letter (a)) [65] and, as a general rule, must be repeated whenever there is to be any significant increase in the loan (art. 18 (6)).

1. How can the likelihood of consumers meeting their obligations be assessed?

Directive 2014/17 consigns to Member States the question of what factors should be used to assess the likelihood that consumers will repay the capital and the interest (art. 18 (1)), and indicates that the main consideration here should not be the hypothetical increase in value of the property used as collateral (except when the purpose of the loan is to build or renovate the property, art. 18 (3)). That is why guarantors' ability to repay cannot be taken into account when assessing that of borrowers [66], without prejudice to the opportunity to assess

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[64] Public Consultation on Responsible Lending and Borrowing in the EU (Brussels, 15.06.2009), pp. 7-8. See Recital 57 Directive 2014/17.

[65] Of this view, Rott, Peter, "Die neue Immobiliarkredit-Richtlinie 2014/17 und ihre Auswirkungen auf das Deutsche Recht", *Zeitschrift für Bank — und Kapitalmarktrecht*, 2015, 8, [pp. 9-14], p. 10. A time sequence that could not be deduced from the articles of Directive 2008/48, as ECJ judgment C-449/13 of 27.03.2014, *Consumer Finance* had the opportunity to point out, without prejudice to the fact that a subsequent creditworthiness assessment may require adapting the explanations already given previously (§§45, 49).

[66] Recital 57 is clear in this sense. With regard to consumer credit, Alessandro Simionato, "Prime note in tema di valutazione del merito creditizio del consumatore

this if the guarantor is the liable for repayment of the debt; naturally, this is not referred to in any of the directives, as contracts of guarantee are not credit agreements [67]. However, guarantors are debtors (subsidiary or joint) and are exposed to lender actions in the same way as the main debtor [68]. Some legal systems expressly refer to assessing guarantor creditworthiness (e.g. Spain [69], Belgium [70] and the United Kingdom [71]).

The regulation imposes no limits on either loan-to-value or loan-to-income ratios and, therefore, does not preclude Member States from setting limits on the amount that can be lent on the basis of "x" times salary, as is standard practice in the United Kingdom. This would be an additional guideline and should not preclude the prior assessment of consumers' income and expenditure and other financial and economic circumstances (Recital 55, art. 20 (1)) [72]. The information required is not specified, only that it must be sufficient and proportionate. Lenders certainly need details of both the nature and duration of consumers' employment, the amount and type of their assets and sources of income, that is, whether or not these are independent of paid work, whether this is permanent or temporary, and whether they have rental income (expressly mentioned in Recital 56, but only in the context of buy-to-let agreements), investments or family benefits or assistance. Other information needed would include the number of adults and/or children that are dependent on applicants' income, as well as the amount and type of regular expenditure (vehicle maintenance, insurance policies, food, lease payments or other expenditure linked with building

nella Direttiva 2008/48", in Giovanni De Cristofaro (ed.), *La nuova disciplina europea del credito al consumo*, Torino, Giappichelli, 2009, [pp. 183-193], p. 186.

67 ECJ judgment C-45/96 of 17.03.1998, *Edgar Dietzinger*.

68 For the purpose of applying Directive 93/13, Order ECJ C-74/15, de 19.11.2015, *Tarc u*, opens the door to non-professional guarantors being just as protected as consumers.

69 Art. 11 (1) Act 5/2019.

70 Code de Droit économique, Arts. VII.69 (1), VII.77 (1) (consumer credit), VII.126 (1), VII.133 (1) (mortgage credit).

71 In relation to mortgage credit, Mortgage Conduct of Business Rules 11.6.2 (1).

72 See, in the United Kingdom, the Mortgage Conduct of Business Rules 11.6.5R and 11.6.7G.

maintenance, social security benefits, savings accounts, taxes, etc.) [73]. Recital 55 suggests that calculations should take into account necessary adjustments, not only in relation to a possible reduction in income but also on the basis of a simulation of the effects of a likely variation in interest rates during a specific time period [74].

Customer information already held by the lender may be sufficient to assess whether borrowers are likely to meet their debt obligations, but as general rule financial institutions have replaced human intervention with sophisticated risk assessment systems (scoring) — the automated assessment alluded to in art. 18 (5) letter (c) — carried out by agencies specialising in customer assessment (rating), that handle the data on customers' payment behaviour; however, banking institutions can also consult public records (art. 9 Dir. 2008/48; art. 18 (5) letter (b), art. 21 Dir. 2014/17). Even so, none of the directives makes it mandatory to check solvency records or databases, nor even set out any criteria for credit registers (e.g. registration thresholds or terms that should be used) [75].

2. Between freedom of contract and prohibition

A fundamental difference between Directive 2008/48 and Directive 2014/17 is that the latter prohibits the granting of credit to consumers with negative creditworthiness ratings, although this is expressed less decisively in art. 18 (5) letter (a) than in art. 14 (2) letter (a) of the 2011 Proposal [76]. Transposing the regulation has required Member States to

[73] Focusing on those points in order to encourage responsible borrowing, see the "Stellungnahme des Gesamtsverbands der Deutschen Versicherungswirtschaft e.V. zum Konsultationspapier der EU-Komission "«Verantwortliche Kreditvergabe und Kreditaufnnahme in der EU»", Berlin, 27.09.2008, pp. 7-8.

[74] See, in the United Kingdom the Mortgage Conduct of Business Rules 11.6.5R (3) and (4).

[75] In contrast, see art. 16 (2) of the 2011 Proposal for a Directive, deleted in the Parliament (amendment 82).

[76] Warning of the change and suggesting that the prohibition on granting credit is not obvious, Schäfer, "Wohnimmobilienkreditrichtlinie…", p. 210; Rita Simon, "Transposition of the Mortgage Credit Directive into Hungarian and Czech Law — The Problem of Credit Intermediaries", *Journal of European Consumer and Market Law*,

include this prohibition in their national laws (e.g. the United Kingdom [77] or Spain [78]), although this prohibition is not explicit in other countries (e.g. Italy [79]). On the other hand, it would not make sense for regulatory changes to be reflected only in mortgage credits. Therefore, French [80], Belgian [81] and German [82] legislatures have extended the prohibition to consumer credit [83]. Mortgage credit can only be granted in Germany if "repayment is likely" and consumer credit only if "there are

2017, 3, [pp. 106-112], p. 107. In Spain, hesitating, Sergio NASARRE AZNAR — Héctor SIMÓN MORENO, "Un paso más en la protección de los deudores hipotecarios de vivienda: La Directiva 2014/17/UE y la reforma del Código de Consumo de Cataluña por Ley 20/2014", *Revista de Derecho Bancario y Bursátil*, 2015, 139, [pp. 11-55], pp. 13, 16, 19. Other authors state that the prohibition does not exist, but on the other hand they hold lenders responsible for the consequences of granting credit irresponsibly. Thus, Matilde CUENA CASAS, "El sobreendeudamiento privado como causa de la crisis financiera y su necesario enfoque multidisciplinar", in Lorenzo PRATS ALBENTOSA — Matilde CUENA CASAS (coords.), *Préstamo responsable y ficheros de solvencia*, Cizur Menor, Aranzadi-Thomson Reuters, 2014, [pp. 27-89], p. 77, followed by LUQUIN BERGARECHE, Raquel, *El crédito al consumo en el contexto de crisis: Impacto normativo y tutela del consumidor*, Cizur Menor, Aranzadi-Thomson, 2015, pp. 300-301. In Italy, Stefano PAGLIANTINI, "Statuto dell'informazione e prestito responsabile nella direttiva 17/2014/UE (sui contratti di credito ai consumatori relativi a beni immobili residenziali)", *Contratto e impresa/Europa*, 2014, 2, [pp. 523-540], p. 537. However, the general sense expressed by academia in Europe is that reflected above in the text. See, among many others, DOMURATH, "A Map…", in MICKLITZ —DOMURATH (eds.), *Consumer…*, p. 168; ANDERSON — SIMÓN MORENO, "The Spanish Crisis…", p. 84; COMPARATO, "The Design…", in MICKLITZ —DOMURATH (eds.), *Consumer…*, p. 19; Piia KALAMEES — Kåre LILLEHOLT — Karin SEIN, "Responsible Lending in Estonian and Norwegian Law", *Journal of European Consumer and Market Law*, 2014, 1, [pp. 29-38], p. 35; MAK, "What is responsible lending…?", p. 426; CHERNYCHENKO — MEINDERTSMA, "Irresponsible Lending…", p. 503.

77 Mortgage and Home Finance Conduct of Business Handbook 11.6.2R (1) (b).

78 Art. 11 (5) Act 5/2019.

79 Art. 120-*undecies* Testo Unico Bancario.

80 Code la Consommation, art. 312-16 (consumer credit) and art. 313-16 (mortgage credit).

81 Code de Droit économique, art. VII.77 (2) (consumer credit) and art. VII.133 (2) (mortgage credit).

82 §505a (1) II BGB.

83 For different solutions adopted at the national level across the EU, see CHERNYCHENKO —MEINDERTSMA, "Irresponsible Lending…", p. 502.

no substantial doubts". This distinction shows that the checks used to assess creditworthiness are also stricter for mortgage credit; put another way, consumer credit lenders could arrive at no other conclusion in view of the limited duty of control Directive 2008/48 imposes, which could perhaps be justified by the fact that the sums to be repaid are relatively small as a rule (cfr. §505b (2) and (3); §505b (1) BGB) [84].

The prohibition certainly encroaches on private autonomy: it conditions lender criteria for choosing prospective customers and for putting their business strategies into practice, and it also conditions consumers' choice of credit. Greater respect for free will would have required obliging lenders to inform borrowers of negative credit ratings but not keeping them from concluding contracts if consumers were aware of the risks on the basis of an informed decision. The negative effects of the prohibition could also be considered: on one hand there is a risk of not holding debtors liable, who could use strategic and opportunistic litigation to complain about lender behaviour; on the other, the costs of borrowing are increased for creditworthy individuals. However, both arguments disregard the fact that lenders are not only better informed but are also better placed to know the risks, and that the prohibition not only protects consumers from their own short-sightedness, but also from banks' tendency towards excessive lending and taking advantage of cognitive biases among borrowers [85]. If over-indebtedness poses a threat to society as a whole, and consumers also usually turn out to be vulnerable, preventative and more general solutions are needed, undoubtedly together with a certain dose of paternalism [86]. On the other hand,

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[84] See *Referentenentwurf: Gesetz zur Umsetzung der Wohnimmobilienkreditrichtline* of 18.12.2014, p. 94 (www.www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/DE/Umsetzung_Wohnimmobilienkreditrichtlinie.html). Jan Schürnbrand, §505a BGB, *Münchener Kommentar zum BGB*, III, München, Beck, 7. Auflage, 2017, Rn 6-7; Markus Artz, §505a BGB, in Peter Bülow — Markus Artz, *Verbraucherkreditrecht*, 9 ed. München, Beck, 2016, Rn. 9.

[85] In this respect, Ramsay, "Regulation…", in Howells et al., *Handbook*…, pp. 394-395. On the effectiveness of credit bureaus for creating a subprime market in the United Kingdom, see Ferretti, "The Legal Framework…", p. 796.

[86] Admitting that it is not easy to say which protection model is best because not all consumers are the same, and acknowledging that the question depends greatly on

excluding members of the public in a high risk category from credit provision — another of the arguments usually raised against the prohibition [87], should not lead to greater social exclusion than decisions to grant it, as shown by the subprime mortgage crisis, which has forced thousands of borrowers out of their homes as a result of foreclosure by unsatisfied creditors [88]. What would not be acceptable would be to refuse credit on the basis of arbitrary or unjustified decisions. In any case, setting reasonable limits is always possible because being unable to repay a specific loan does not necessarily mean being unable to repay another. Furthermore, it should be noted that Directive 2014/17 permits loans granted to a specific sector of the public on special terms by social banks, cooperatives and local authorities to be excluded from its scope (art. 3 (3) letter (c)) which includes being able to dispense with creditworthiness assessments for such cases; hence, there is no prohibition on granting credit should the debtor be at risk of over-indebtedness.

3. The consequences of creditworthiness assessment

Member States are responsible for determining the consequences of granting credit contrary to the prohibition (art. 38 Dir. 2014/17). Directive 2014/17 only provides for the remedies available to lenders when it is consumers who are imprudent and do not meet their pre-contractual obligations (arts. 18 (4), 20 (3) III and (4)). This is one more sign that the responsible lending policy cannot work effectively according to the European Union if borrowers do not behave appropriately [89],

local markets, Mak, "The Myth…", pp. 259 ff. Mak — Braspenning, "*Errare humanum est*…", p. 327, believe that a general prohibition for all types of consumers is an extreme solution. Also raising objections, Ferretti, "The Legal…", pp. 815-816.

87 Esperanza Gallego Sánchez, "La obligación de evaluar la solvencia del deudor. Consecuencias derivadas de su incumplimiento", in Prats Albentosa — Cuena Casas (coords.), *Préstamo responsable*…, [pp. 207-242], p. 222, pp. 238-239.

88 Comparato, "The Design…", in Micklitz —Domurath (eds.), *Consumer*…, pp. 12-14; Domurath, "A Map…", in Micklitz —Domurath (eds.), *Consumer*…, p. 168; Reifner, "European…", in Twigg-Flesner, *The Yearbook*…, p. 426.

89 Public Consultation on Responsible Lending and Borrowing in the EU (Brussels, 15.06.2009), p. 3, p. 10.

especially if they are capable of lying to obtain credit [90]. However, if in accordance with art. 20 (1) final and 20 (3) Directive 2014/17, consumers are required to provide documentary evidence of information (salary slips, tax returns, average current account balance statements) [91] and credit cannot be granted if the information is withheld or cannot be verified (art. 20 (4)), deception will certainly not be easy and it would consequently constitute a lack of diligence on the part of the lender not to detect it (e.g. it is easy to spot whether salary slips are for months in which bonuses were paid). This is especially true when institutions have to be able to request clarification and independently verify what consumers tell them (art. 20 (1) and (3)), although they are not always obliged to do so (art. 20 (1), "when necessary") [92]. Nonetheless, there will always be scenarios that are difficult to check: consumers may hide the fact that they know they are going to lose their jobs and their incomes will therefore fall; they may not give details of all their financial obligations, or they may fail to give details of outstanding repayments on loans granted by other institutions. It is impossible to check the latter without consulting customer credit histories, and these records may differ from one country to another (there are both public records [credit registries] and private records [credit bureaus], which hold positive and/or negative information), or may not function efficiently in all countries, either because loans for a particular amount are not recorded, or because there is no historical record of data, or because not all lenders have access to them, or finally because borrower consent is needed for the data to be processed [93].

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[90] Public Consultation on Responsible Lending and Borrowing in the EU (Brussels, 15.06.2009), p. 10. The problem seems to refer specifically to self-certification mortgages, which require no proof of income and have been common practice in the USA, UK and Ireland. See Financial Services Authority, Mortgage Market Review: Responsible Lending, July 2010, §§2.19-2.20.

[91] On the basis of art. 8 Directive 2008/48, see ECJ judgment C-449/13 of 18.12.2014, *CA Consumer Finance* (§37).

[92] Once more, ECJ judgment C-449/13 of 18.12.2014, *CA Consumer Finance* (§§38-39).

[93] See, for instance, Andrea Fejős, "Mortgage Credit in Hungary", *Journal of European Consumer and Market Law*, 2017, 3, [pp. 139-143], pp. 141-142. Arguing in favour of positive creditworthiness records to prevent over-indebtedness, Matilde Cuena Casas, "Intercambio de información positiva de solvencia y funcionamiento del

The Directive says nothing about what happens if lenders give credit without previously assessing creditworthiness (a scenario that would have to be considered unlikely nowadays) or do so when risk assessments are negative or are manipulated to produce positive results. All that arts. 18 (4) and 20 (3) II provide for is the inability of lenders to modify, cancel or terminate agreements when they realise, after the signature of the credit agreement, that the assessment of creditworthiness was incorrectly conducted due to incomplete information at the time of the creditworthiness assessment (Recital 58). Therefore, leaving aside cases when debtors are to blame for manipulating the information [94], lender error, misconduct or negligence would not prevent consumers from continuing to enjoy the capital. However, what if they could not pay it back?

3.1. Between public and private law

Since the duty to assess creditworthiness is frequently incorporated into prudential standards whose aim is to control and supervise the banking system as a whole, there is some debate over whether any infringement could entail private law penalties in addition to administrative sanctions (expressly provided for in art. 38 (2) Dir. 2014/17), among them, lenders' civil liability [95].

Directive 2014/17 suggests that private law remedies should only be applied when it is borrowers that do no not act responsibly (Recital 83), and thus appears to avert the risk that art. 18 (5) letter (a) will

mercado de crédito", *InDret*, 2017, 3, pp. 1-67 (www.indret.com). In contrast, questioning the role of credit bureaus, Ferretti, "The Legal…", pp. 815-817.

94 In seems that in these cases termination would indeed be possible (art. 20 (3) III, Recital 58). In many legal systems there is speculation in such cases about challenging void contracts that are vitiated by error. Italian academic writing is an example of this rationale. See Francisetti Brolin, "L'art. 124-*bis* del TUB…", pp. 569. If these were immovable contracts, it is not clear what advantages this solution would have over the more forceful remedy of declaring the loan due and initiating the enforcement procedure.

95 For more detail, Simionato, "Prime note…", in De Cristofaro (ed.), *La nuova disciplina…*, pp. 188-192. ECJ judgment C-222/02 of 12.10.2004, *Peter Paul* understands that no right to individual protection derives from the prudential standards for supervising the banking sector (§§44, 46-47).

be understood to have be transposed incorrectly if the prohibition is only incorporated into prudential standards. It would then be said that as the legal policy objective of regulations of this kind is to defend the public interest, avoiding over-indebtedness is in the general interest of the financial system and the particular interest of banks, in whose business risk is implicit [96]. Consequently, the administrative sanctions provided for in each case, according to the severity of the infringement, would be sufficient. However, the Directive pursues not only the stability of the financial system, but also a high degree of consumer protection (Recitals 5-7, 49, 81-82). No doubt should be cast on the fact that this includes borrowers' individual rights to creditworthiness assessment, and any violation of this duty on the part of lenders should naturally have civil consequences. Administrative sanctions serve to drive unfair competitors out of the market, but they have no individual or direct benefits for consumers. Two ECJ judgments have confirmed that civil sanctions are both possible and necessary [97].

3.2. Between interest loss and reduction

It has already been noted that the 2002 Consumer Credit Directive Proposal included the possibility of loss of interest (art. 31 (2)). As its incorporation into the final draft of the regulation was rejected, if adopted in Member States the measure could have run the risk of being considered disproportionate were it possible to understand that protecting consumers did not always entail disregarding lenders' interest

[96] Concerning Directive 2008/48, Stefan Grundmann, "EC Financial Services — Developments 2002—2005", *European Review of Contract Law*, 2005, 4, [pp. 482-494], p. 488: "[…] a behaviour which so far rather aimed at self-protection would now be imposed on banks." For the arguments, with references to German writing, Hofmann, "Die Pflicht…", p. 1783. In Spain, Gallego Sánchez, "La obligación…", in Prats Albentosa — Cuena Casas (coords.), *Préstamo responsable*…, pp. 239-240.

[97] ECJ judgment C 565/12 of 27.03.2014, *Crédit Lyonnais*; ECJ judgment C-449-13 of 18.12.2014, *Consumer Finance*. See Artz, §505a BGB, in Bülow — Artz, *Verbraucherrecht*, Rn 5; Alisa Rank — Martin Schmidt-Kessel, "Mortgage Credit in Germany", *Journal of European Consumer and Market Law Review*, 2017, 4, [pp. 176-179], p. 177.

in remuneration [98]. To some extent this is the philosophy behind §505d (1) BGB, which only provides for reducing interest that would have been earned had the lender used the capital for a secure investment instead of providing the loan [99]. Accordingly, a fixed interest rate will be replaced by the customary interest rate for German mortgage-backed bonds and German public-sector bonds, and a flexible interest rate will be replaced by a customary interbank rate, provided these are not higher than those agreed-upon in the contract [100]. However, in judgment C 565/12 of 27.03.2014, *Crédit Lyonnais*, the ECJ instead understood that the penalty involving the forfeit of contractual interest was a poor deterrent if not also accompanied by the loss of statutory interest [101]. As well as France [102], countries such as Belgium [103] and Switzerland [104] have provided for the forfeiting of interest; in Switzerland lenders may even lose the right to the repayment of capital in case of serious violation, something which Germany expressly rejects [105], and the consumer can also ask for the repayment of the amounts he has already paid [106].

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98 Thus, Christoph Brenner, *Die Verbraucherschützenden EG-Richtlinien im Bereich des Schuldrechts und Ihre Umsetzung in Deutschland und Frankreich. Auf dem Weg zu einem europäischen Privatrecht?*, Akademischer Verlag, München, 2000, p. 180. Also, Köndgen, "Policy…", in Grundmann — Atamer (eds.), *Financial Services*…, p. 51, believes that there is a risk of unfair consumer enrichment. Stressing the effectiveness of this sanction, on the other hand, Silvia Díez Alabart, "Evaluación de la solvencia del consumidor, tasación de inmuebles y consultas en ficheros de solvencia", in Silvia Díaz Alabart — Patricia Represa Polo (eds.), *La protección del consumidor en los créditos hipotecarios (Directiva 2014/17)*, Reus, Madrid, 2015, [pp. 223-276], p. 237.

99 Artz, §505d, in Bülow — Artz, *Verbraucherrecht*, Rn 6. The reduction is excluded if a proper assesment of the creditworthiness would have a positive result. See also, Rank — Schmidt-Kessel, "Mortgage Credit in Germany", p. 178.

100 Rank — Schmidt-Kessel, "Mortgage Credit in Germany", p. 178.

101 ECJ judgment C-565/12 of 27.03.2014, *Crédit Lyonnais* (§55).

102 See now Code de la Consommation, Arts. L 341-27 (3) and L 341-28.

103 Code de Droit économique, Arts. VII.201, VII.209 (1er).

104 Loi federale sur le credit à la consommation, art. 28 (1), art. 32. According to art. 7.1 (a) mortgage credits are excluded.

105 Artz, §505d, in Bülow — Artz, *Verbraucherrecht*, Rn 4 ss.

106 See on that Anne-Christine Fornage, "Vers un droit de crédit à la consommation plus responsable", *Journal des Tribunaux*, 2017, 1, [pp. 4-46], pp. 28 ff, esp. pp. 34-35.

3.3. Claim for damages

Should the national laws not provide for a specific private law penalty, it should be possible to hold lenders liable by applying the general rules [107], perhaps even cumulative to administrative sanctions (which may not always be required; if the lender's behaviour is not repeated, for example). This would not be opposed by Recital 56 Directive 2014/17, which, given its systematic positioning, only refers to scenarios in which creditworthiness has been assessed correctly. The prohibition on extending credit to those who do not have the appropriate profile should not lead to to contract annulment [108].

If the possibility of claiming damages is accepted, the problem lies in determining exactly what borrowers can claim [109]. The answer would be that the damage is the agreement itself, so judges will have to take into account the difference that should ideally exist between the agreement actually concluded and the agreement that the consumer

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[107] In favour of an individual right to redress, regarding art. 8 Dir. 2008/48, Rott —Terryn —Twigg-Flesner, "Kreditwürdigkeitsprüfung…", pp. 166-168. In Germany, Hofmann, "Die Pflicht…", p. 1785; in Estonia, Kalamees-Lilleholt —Sein, "Responsible Lending…", p. 32, pp. 36-37; in Spain, María Cruz Mayorga Toledano, "Obligaciones de la entidad de crédito en la concesión de crédito adecuado a la solvencia y capacidad de endeudamiento del cliente", in M.ª de la Sierra Flores Doña — José Tomás Raga Gil (dirs.), *El préstamo hipotecario y el mercado del crédito en la Unión Europea*, Tirant lo Blanch, Valencia, 2016, [pp. 353-377], p. 373. Concerning Directive 2014/17, stating this in Italy, Pietro Sirena, "Introduzione. Autonomia privata e vigilanza bancaria nel diritto europeo dei contratti di finanziamento", in Pietro Sirena (cur.), *I mutui ipotecari nel diritto comparato ed europeo. Comentario alla direttiva 2014/17/UE*, Grupo24ore, Milano, [pp. 3-8], p. 8.

[108] Expressly, in Germany, see *Referentenentwurf*: "Die Verbote des Absatzes 1 verdeutlichen den Zweck der Kreditwürdigkeitsprüfung, stellen aber kein Verbot gemäß §134 BGB dar, das zur Nichtigkeit des Darlehensvertrags führt (vgl. §505d BGB)", p. 95. In Portugal, Jorge Morais Carvalho, *Manual de Direito do Consumo*, 5a ed., Coimbra, Almedina, 2018, p. 413. For discussion in Spain, Anderson — Simón Moreno, "The Spanish Crisis…", pp. 83 ff.

[109] Köndgen, "Policy…", in Grundmann — Atamer (eds.), *Financial Services…*, p. 51. Part of German academia rejects the possibilty that the sanction provided for in §505a BGB can be cumulated with claims for compensation, ex §280 BGB. Thus, Artz, §505a BGB, in Bülow — Artz, *Verbraucherrecht*, Rn 15. But see Rank — Schmidt-Kessel, "Mortgage Credit in Germany", p. 178.

could really have afforded. If not even this is possible, that is, if the consumer really had no ability at all to repay, then it would probably be necessary to consider the possibility that the loan was unenforceable and the consumer will be released from repaying both the capital and the interest [110].

V. FINAL THOUGHTS

Both Directive 2008/48 and Directive 2014/17 aim to create an internal credit market and protect consumers, but in the first Directive the somewhat vaguely defined principle of responsible lending was seen as a stumbling block (too great a burden for the industry) [111], while the second was enacted when the economic and finantial crisis had already erupted, as a consequence of which more emphasis was placed on sustainability in borrowing, for the benefit of both consumers and the financial system [112]. This required adopting new and rather more forceful measures to tackle the problem of over-indebtedness, although ultimately there are question marks over the usefulness of some of the measures, such as the need to supply a wealth of pre-contractual information that consumers do not understand and establishing a period of reflection for offers, before which loans are not available but that consumers can disregard anyway if national legislation provides for this.

According to one study, before the enacting of Directive 2008/48, whose scope of application, moreover, excludes mortgage credit, Member States rarely had legislation in place that obliged lenders to assess potential borrowers' ability to repay, and when they did it was not

[110] In relation to consumer credit in Austrian law, see Zöchling-Jud, §7 VKrG, in Wendehorst — Zöchling-Jud, *Verbraucherkreditrecht,* Rn. 45-46, pp. 193-194. In Germany, Hofmann, "Die Pflicht…", p. 1786; Artz, §505a BGB, in Bülow — Artz, *Verbraucherrecht*, Rn 15.

[111] Rott, "Consumer Credit", in Micklitz *et al*., *Understanding*…, p. 185.

[112] On the regulation's legal policy aims, see Recitals 2, 3, 5-6 Dir. 2014/17. Mak, "What is Responsible Lending…?", p. 413; Comparato, "The Design…", in Micklitz — Domurath (eds.), *Consumer Debt*…, pp. 16-17.

always effective as there was no provision for sanctioning infringements [113]. The reluctance with which Directive 2008/48 approached the problem is also in contrast to the legislature's firm commitment in Directive 2014/17. In accordance with the latter, lenders must not offer credit to consumers who are not in a position to pay it back, which is perfectly reasonable and necessary, not only to strengthen banks — the banking system in general — but also to protect lenders' interests. Precisely because lenders cannot grant loans that are not suitable for consumers' needs or financial circumstances, it could be concluded that there is an implicit duty to advise them as to what is best for them, even though no directive expressly says so.

The notion of responsible lending goes hand in hand with responsible borrowing, but it is clear that the duty of prudence falls firstly on lenders, who have greater experience and more information than any creditor can have about their debtor. It is therefore logical that consumers can hold lenders liable when they grant credit over and above the advisable limits, although the directives once again remain silent on this point. The prohibition on granting credit cannot solve the problem of over-indebtedness once and for all, as its roots also lie in external causes (divorce, illness and unemployment), but will undoubtedly contribute to preventing unfair practices and to protecting the banking sector against its own excesses.

[113] See European Commission, Directorate General for Employment, "Towards a common operational European definition of over-indebtedness", Brussels, 2008, pp. 67-68.