Contribution to the Responsible lending and borrowing consultation

Name of the organisation: BUBEBA

About Bubeba :

BUBEBA is an initiative who has the particularity of being run by professionals of the consumer finance and the banking industry. We believe that responsible banking is a basic benefit, an urgent need for society and bank's survival. We believe that the role of banks are to participate positively to the major societal changes of tomorrow. We want them now to be integrated into their community, to be vectors of change, to be more sustainable, to be more respectful and to be more committed.

"In its Communication to the Spring European Council Driving European Recovery of 4 March 2009, the European Commission undertook to come forward with measures at EU level on responsible lending and borrowing, including a reliable framework on credit intermediation, in the context of delivering responsible and reliable markets for the future and restoring consumer confidence. Responsible lending means that credit products are appropriate for consumers' needs and are tailored to their ability to repay. This may be obtained through having an appropriate framework in place to ensure that all lenders and intermediaries act in a fair, honest and professional manner, before, during and after the lending transaction. Responsible borrowing implies that – in order to obtain a credit – consumers should provide relevant, complete and accurate information on their financial conditions, and are encouraged to make informed and sustainable borrowing decisions ».

The most important but maybe the least obvious element of the introduction of the consultation is the urgent need for banks "to restore consumer confidence". One could not enough insist on the importance of this objective.
Some years ago, Bill Gates said: "in a modern economy we need banking, we don't need banks". Ever since, non-banks, companies with a captive audience , such as social platforms, etc … look forward taking over bank's activities.
And the –increasing- feeling of the citizens about those newcomers is that they are trustful, at least as much as banks are, especially since October 2008.
Banks and financial institutions get now with this directive and other frameworks a second chance to become again the symbol of trust.

As banking and consumer finance professionals, we know for sure that banks can't change dramatically their operating models unless they are helped to do so. This is the purpose of our contribution to this consultation.

BUild a BEtter BAnk

For a better world

Question 1: *Do you have evidence of misleading or unfair advertising or marketing practices with regard to mortgage and consumer credit?*

The answer is yes.
As we want to ensure that our insights are used in a responsible way, the complete, and documented file on this section is available upon request. Unfair practices are also put into the context and the business strategy.

Summarize of the categories of documented items

- Deliberate non respect of TAEG/APR calculation methods
- Non respect of maximum legal rates
- Organized unreadibility of revolving accounts statements
- Unfair marketing advertising
- Sales maximization strategy at cost of consumer interest
- Subsidize and unofficial bundled sales
- Unethical sales process / approaches
- Non respect of consumer credit legislation
- Unethical behaviours / sales process

Below we quote 1 unethical practice particularly significant on the urgency of setting up the regulatory responsible lending framework as his practice has been initiated by a major operator and after the October 2008 crisis.

<u>The sale of credit lines in “opt-out”</u>

- Description of practice:
  bank / financial organization sends its customers a letter informing them that, without response / denial from them within 2 weeks, a line of credit will be in force on their current account.
- Commentary:
  This sales approach is unethical but legal. It has its roots in the exclusion of certain credit products within the scope of the legislation on consumer credit.

  One will note that this opt out selling practice has been implemented while simple opt-out e-mails (the so-called spam) have already banned/legally forbidden in most countries of the EU. Again, is it a surprise ? banks operating business model didn’t change since October 2008. Bank’s performance indicator is still the stock prize.

Note: In 1960, an average share on the stock exchange changed hands every 7 years. Today that average has fallen to 7 minutes. Is this a surprise ? Profit-based measurement systems have always been oriented towards investors. And as a result bank management has always given top priority to delivering shareholder value. Yet, paradoxically, lies one of the root causes of the decline in investor loyalty. Bank executives strive to measure and manage its mirror image, the flow of value from investors to the bank. As a result, they also fail to make any attempt to find the right investors to begin with, the way they do (or ought to do) with customers and employees. In this regard, the October 2008 crisis is an opportunity to highlight that the systemic aspect of the crisis has not yet been acknowledged

Question 2: *What are your views on the development of risk guidelines?*

The current reality encountered when working in a bank or financial institution selling loans..is that the consumer finance sector won't start a real approach of responsible lending unless forced to do so. . (by "real", we mean honest and efficient , ie we exclude from this definition the "greenwashing" initiatives ie like dedicated or corporate websites that are only targeted to journalists or public authorities)

Alike intermediaries of other economic sectors, the credit intermediary is balanced between the moral concern to help his client and the system pressure (bonus, incentives, commission structure, sales objectives to be achieved to keep his job, ..).Yet the rules to ensure responsible lending are simple, some being already in place in some countries. The axis are

Implementation of a maximum interest rate.

- some countries do not have any kind of ceiling on the credit rates charged to customers. The absence of this ceiling has 2 major negative impact on consumers protection.
  1. it obviously allows financial institutions to charge the interest rate they want to the consumer.
  2. As the rate charged to the customer is an important element of the acceptance policy, the absence of ceiling "invites" financial institutions to take higher risks. Concretely it allow banks to grant loans to people who should not be eligible. hence an increasing danger of over-indebtedness.

▪ Spain	no
▪ Italy	no
▪ The Netherlands	yes
▪ Belgium	yes
▪ France	yes
▪ Germany	no
▪ Portugal	no
▪ Greece	no
▪ Poland	no
▪ Hungary	no
▪ Denmark	no
▪ United Kingdom	no
▪ Sweden	no
▪ Finland	no

- One will note that in one country where the ceiling is implemented, we would welcome the implementation of an appropriate mechanism to determine the ceiling rate (the ceiling rate is calculated with a "trivial" method. Central bank identify lending rates applied by the market and then make an average. The average of the rates applied in the market is the legal max rate. Obviously, this mechanism encourages the key players (of course aware of the calculation mechanism) to establish latent agreement on the rates charged to customers.

<u>Establishing a EU common policy and control of over-indebtedness</u>

- The commercial attractiveness of a market / country for a financial institution that sells consumer credit products is closely linked to the legislation that regulates the debt overhang. In this regard, there are wide disparities in Europe, some countries have a strong policy of management and control in others there is almost nothing. The positive database is one of the major element of the control on over-indebtedness.

▪ Spain	no	
▪ Italy	yes	but partial
▪ The Netherlands	yes	
▪ Belgium	yes	
▪ France	no	
▪ Germany	yes	
▪ Portugal	no	
▪ Greece	yes	
▪ Poland	no	

- Hungary no
- Denmark yes
- United Kingdom yes
- Sweden yes
- Finland yes

- A control and management policy of indebtedness must be understood in its broadest sense

  - Set up of relevant and reliable indicators and monitoring
  it means that the information system should not be managed by the sector as it is sometimes the case in some countries

  - Active supervision by public authorities of the catalysts of household over-indebtedness ie
    - rules for calculating household debt burden
      Even in the most controlled markets, these elements are not subject to effective control by public authorities

      1. Example: a financial institution/Bank CEO can decide solely to increase debt burden ratio and to go for instance from 40% up to 70 % of total household income.

      2. Example: a financial institution/Bank CEO can decide solely to adapt the "cut off score" (ie the cut off score is the limit of the credit scoring that traces the line between the loan applications that are automatically accepted and the ones that are refused)

      3. Example : An effective scoring system is the foundation of an efficient consumer finance activity. Overtime a credit scoring system loose relevancy (especially in a time of recession) and a s a result may negatively impact over-indebtedness rate.

         the indicators signalling that a credit scoring is no longer effective are
         - the evolution of the "low side" overrides (loan manually accepted altough the automatic approval system refused) and the "high side" overrides (ie the contrary)
         - the gaps on the population stability indicator/curve which measures the volume of loan demands predicted and the actuals. This indicator is the first signal of a deterioration of the effectiveness of the credit scoring model.

4. Example : Personal sales objectives (ie acceptance rate, sales production) are sometimes assigned to employees acting both as sales representatives and as credit officer granting loans. The conflict of interest is this situation is obvious.

Some of the negative impacts of the decisions here above mentioned examples will appear some years later after their implementation .... so the question is : in our current economic world, in recession, with financially and sociability weakened consumers, a world focused more than ever since October 2008 on immediate revenue generation, …. can we leave those decisions without any control or supervision from the authorities ?

Question 3: *In your view, are there certain (categories of) credit products that are inherently unsuitable for sale to retail borrowers? Would you welcome a set of standardised or certified credit products to be offered to consumers?*

Some products (if not forbidden) should be more controlled. Revolving credit for instance. It's relative complexity (generally no fixed monthly instalment and as result an increasing difficulty for an household to establish a sound financial planning) it's long-term impact on the household budget (no clear end-of-credit date .. a 15.000 euros revolving line will end up after a 12 to 14 years period, depending on the rate charged, the reimbursement scheme…note also that over this period 8.000 to 11.000 euros interest will be paid on average by the consumers) it's risk of over-indebtedness (no clear view on what part of capital vs interests consumers are paying).

In this perspective, we recommend to limit the amount of the revolving credit lines that can be granted to consumers. An amount up to 5.000 euro sounds more than enough. Higher amounts should be granted to consumers under the form of finance or personal loans with a fixed end-of-date loan.

We recommend also to implement a regular review whether the revolving line granted once should still be granted. Either cancel all revolving lines aged > x years or implement a process to ensure that a revolving line once granted to a consumer and revolving line only becoming active 5 years after being granted at a moment where the financial situation of the consumer might be completely different. The overall outcome would be to ensure affordability.

Question 4: *Do you consider that mortgage lenders and credit intermediaries should always perform creditworthiness and/or suitability assessments before granting consumer and mortgage loans? For mortgage credit, what are your views on the criteria to be used in assessing suitability such as loan-to-income ratios or loan-to-value ratios?*

The main reason of the very existence of the credit intermediaries is in their ability to make assessments on consumer's affordability . Banks and Financial institutions should therefore welcome the mandate to systematically conduct assessments of repayment capacity of borrowers as it is in a way protecting their business on top of protecting the consumer.
The obligation to conduct an assessment of the suitability of a loan is not just a good thing, it is a mandate. It is irresponsible for financial institutions to promote repetitively loan consolidation duration in excess of the depreciation duration of the goods or services initially financed like it is the case today. It is also unfair and unethical to repetitively sell to consumers consolidation loans whose interest rate are sometimes (far) higher than the initial loans.

For mortgage as for consumer credit, the ratio to take into account is the loan to income ratio. The golden rule in consumer credit is "affordability'. You do not grant a loan to an individual based on the collateral or the value (else you will provoke side effects and unethical behaviours) but based on the idea that the customer will be able to repay you month by month without incident.

Question 5: *How should the lender or credit intermediary demonstrate or document the adequacy of the creditworthiness and suitability assessment?*

Creditworthiness should be done through several debt burden analysis: a combination of 3 analysis is recommended. Each analysis should be positive. Exceptions are possible based on facts and should be documented in customer's file . Evolution of the number of exceptions is subject to a close monitoring/regular review. This review could integrate also information about the evolution of the cut-off score, te high and low side overrides.

- Analysis of solvency : amount of the monthly instalment vs total household (HH) income : ➔ percentage
- Analysis of debt:
total household charges/(new loan instalment integrated) versus total household income : ➔ percentage
- Analysis of min amount per person
(total income of the HH minus total charges) divided by the number of person in the household : ➔ amount in euros

Question 6: *Do you think that these advice standards would be appropriate in an EU context? Are there others that should be considered? What would be the most appropriate means to introduce and enforce the application of advice standards? Please explain.*

The MiFID directive is a good example to follow. But it has to integrate the particular situation of consumer lending. For investments/deposit, banks are looking to get consumer's confidence … for consumer finance products it is the other way around. One will also note that "low end" customers will consider that a good bank is the bank who grant a loan bigger they initially demand/need. Therefore we should

- ban from the sales process mechanisms allowing credit intermediaries to maximize loan amounts and to ensure that sales mechanisms capture the amount of the loan really needed (hence the importance of knowing the purpose of the loan)

- Enforce that disbursement of loans can only occur for loan amount > xxxxxx euros within xxxx days after loan approval. (allowing customer to think twice on the relevancy of the loan, even ifit is 1 day… the objective is to avoid compulsive purchasing behaviours when large amounts/impacts are at stake). The opportunity for customers to cancel their loan within 2 week after signature is completely ineffective as the money of loan is generally spend as fast as it is granted and disbursed by some lenders. (ie in minutes..)

- Ensure that the major financial information used in the debt burden analysis (monthly rent/mortgage paid the consumer , existing loans where positive database is not available) are double checked

Question 7: *Apart from a focus on financial education, are there any measures that could be taken to encourage responsible borrowing?*

As financial education is a good thing, we have yet to analyze the extent to which this education takes place and is operationally executed. Indeed we must remember that the public targeted by consumer credit are in the consumer finance jargon "low end" consumers, a public often financially and socially weakened. A public who often relies solely on the advice of the banker / broker. Therefore the need to incorporate virtuous mechanisms / alert – advice messages in the client-credit intermediaries interactions (ie the sale process)

BUild a BEtter BAnk

For a better world

As mentioned in our reply to question 6. Responsible lending is at 80% the responsibility of the lender since the typical consumer finance customer rely solely on the advice of the credit intermediary. An aggravated element is the weakened status of a demander in a sales process. Consumers should also be protected of unofficial bundled sales of insurances in a face to face process (one will note that the penetration of insurance sales in a remote sales process is far less than in a face to face process.

Question 8: *Do you consider that the scope of the definition of Credit Intermediary as set out in the Consumer Credit Directive could also be applied to the mediation of credit not covered by that directive? Would it be appropriate to differentiate between full-time credit intermediaries and persons who offer credit intermediation on an incidental basis? Please explain why (not).*

The concept of credit intermediary should, in our view, include casual credit intermediaries. Informal intermediaries remunerated for lead generation are countless and the share of the fee they get when selling consumer loans has become over the years increasingly important for them as new insurance products (more or less bundled) are sold to the customer. (the car financing is the most significant example of this phenomenon but e-shops are now also concerned.

In addition, accreditation of credit intermediary ensures a certain level of knowledge/skills of the credit intermediary in a context where financial education / budget management is also a mean to achieve responsible lending

Question 9: *Do you think policymakers should make distinctions between credit intermediaries in terms of the products they sell (mortgage, consumer credit, 'point of sale' credit)? Should credit intermediaries be treated differently in terms of the status of their relationship with lenders (tied versus untied intermediaries)? Please explain your answer.*

We should not make difference between the types of products (with the potential exception of mortgage) and for several reasons
- Loans granted to small amounts in the store are designed to be "hook products to sell larger amounts of credit in a later and cross sell phase. Therefore it is important to provide advice/education on lending as soon as one begins his working life and that one is targeted by consumer finance advertising.

- The criteria for access to the intermediary function of credit should be the same for funding for a car or personal loan because the monthly unpaid potentially have the same impact in the household budget. (hence the need for special attention when selling a mortgage loan)

Question 10: *Could you give examples of cases of misconduct, mis-selling or any other instances of consumer detriment linked to credit intermediaries in your country?*

Yes. a detailed document is at disposal upon request.

- Non respect of TAEG/APR calculation methods
- Organized unreadibility of revolving accounts statements
- Unfair marketing advertising
- Sales maximization strategy at cost of consumer interest
- Subsidize and unofficial bundled sales
- Unethical sales process
- Non respect of consumer credit legislation

Question 11: *Does the regulatory patchwork for credit intermediaries present a problem, in your view?*

No. The potential differentiation should be made for mortgage. An easy to implement requirement: any consumer introducing a demand for a mortgage should get 3 offers with at least 2 different durations. If the initial customer demand is to borrow on 25 years, the customer should also get a 20 et 15 years reimbursement duration proposals. The proposals would highlight the balanced decision to be taken (choice over the relative high amount of interest to be paid on a longer period versus the small decrease in the monthly instalment)

Example:
200.000 euros on 15 years at 4% =
1.479,38 euros/per month and 66.237,58 euros interest paid over the period

same on 20 years
1.211,96 euros/per month and 90.870,46 euros interest paid over the period

same on 25 years
1.055,67 euros/per month and 116.701,97 euros interest paid over the period

for instance, the proposal would highlight that the 200 euros difference a month between 15 y and 20 y reimbursement cost some 25.000 euros interest more …one can think that this information would be particulary helpful for consumers to make a sound decision on a loan most consumers do once in a life time.

Question 12: *What would be the most appropriate way to address potential conflicts of interest, particularly with regard to fee/ bonus/ commission structures? Should any measures in this regard apply to bank client-facing staff as well as intermediaries?*

- This is not the structure of bonuses that are involved but their existence. We note for example that responsible banks (ie Triodos), do not pay any bonus to any member of staff, including management.
- Incentives encouraging wrong attitudes (ie maximization of sales at the cost of the right advice) should be banned
- Commissions should integrated the reimbursement performance / the write offs of the files initiated.
- Commissions should not (solely) be linked on the interest rate applied to the loan.
- Commission structure should be seen as a whole (ie including the commissions paid for the selling of bundle products or products integrated in the sales flow (insurances)
- The commission structure should be annually reviewed by market authority. Changes to the commission structure and their impact (hypothesis) should be documented and explained.

Question 13: *What are your views on the registration and supervision of credit intermediaries?*

It seems obvious after the Sub-Prime crisis in 2008 that bank activities need more control. So the registration, access to the profession is obviously a mandate as well as the regular review of their financial health.
Those operations and control need to be performed by the public authorities and not by agencies funded by the profession

Question 14: *What are your views on prudential and professional requirements for credit intermediaries (such as minimum capital, professional indemnity insurance, educational or professional qualifications)?*

The strength of a chain is to be measured up to its weakest point. In the case of responsible lending, the weakest point of the chain is not the skills nor the level of capital, nor the training of the credit intermediary. No, even with the most competent credit intermediaries, best covered by liability insurance, with the longest experience, the best skills ... if the model for assessing the performance of the credit intermediary remains focused solely on the measure of profitability. Well we will never achieve responsible lending and consumer protection.