Consumer Credit & Responsible Lending

Your Partner For What's Next

Background

In recent months there has been an increased focus at a European Union (hereinafter "EU") level on conduct-related issues, fair treatment of borrowers and responsible lending practices. Irresponsible lending and mis-selling in the consumer credit market are key causes of over-indebtedness, resulting in negative implications for individual consumers and for long-term economic stability. In March 2021, the European Banking Authority (hereinafter "EBA") released its most recent consumer trend report, identifying over-indebtedness as a key trend in the consumer credit market.

Finance Watch is a European non-governmental organisation, who defend the public interest in the making of financial regulations. In February 2021, Finance Watch released the results of a study conducted to identify the reasons for mis-selling and irresponsible lending in the consumer credit market. The study focussed on 89 case studies collected from three Member States (including Ireland) and the central EU legislation regulating consumer credit, the Consumer Credit Directive (hereinafter "CCD"). It is anticipated that the study will reinforce debate and encourage reforms to the CCD. The following consumer credit products were considered:

- Payday loans ≤ €180;
- Car loans ≤ €20,000;
- Personal loans ≤ €2,500; and
- Revolving credit (a credit which is automatically renewed as debts are paid off e.g. credit cards) ≤ €1,500

The findings and recommended revisions to the CCD identified by Finance Watch are broadly in line with those identified by the European Commission (hereinafter "the Commission") as part of its public consultation process. For more information on the Commission's public consultation process, please visit our website: [Consumer Credit Directive - Risk Consulting - KPMG Ireland (home.kpmg)]

A summary of Finance Watch's findings and recommended revisions to the CCD are set out below.

Findings

The following is a high-level summary of Finance Watch's findings:

- Provision of **pre-contractual information** has several issues such as:
  - Many credit providers only provide pre-contractual information at the time the customer signs the contract, i.e., it is not provided in a timely manner to allow comparison of products;
  - The format in which information is displayed is lengthy and complex. Interest rates are displayed more prominently than unfavourable Annual Percentage Rate (hereinafter "APR"). Therefore, consumers have difficulty understanding costs, particularly the consequences of missing payments; and
  - Consumers have greater difficulty accessing and understanding pre-contractual information when using an online sales channel.
- Personalised unsolicited **advertising** is likely to increase due to increased digitalisation and may encourage consumers to borrow beyond their means. The presentation of information may divert consumer focus in the following areas:
  - Cost comparison of interest rates and APR; and
  - Maximum loan amount for revolving credit facilities online.
- Poor **creditworthiness assessment** (hereinafter "CWA") practices may lead to the mis-selling of credit to consumers. This is more common in non-bank loan providers (e.g. insurance corporations, pension funds, financial auxiliaries, digital peer-to-peer lenders). These practices include:
  - Only considering income levels and not levels of expenditure;
  - Many credit providers do not collect supporting evidence to verify information provided;

- Collection of consumer data that has no relevance to the ability to repay a loan, e.g. housing type / previous address, which can lead to refusal of credit based on discrimination; and
- In many cases, no satisfactory reason is given where a credit application is rejected.

- Specific **types of credit**, which are not currently in the scope of the CCD, are often provided at a high cost to consumers and lack quality pre-contractual information. These include:
  - Payday loans under €200; and
  - Revolving credit under €200.
- Advice regarding **affordability and suitability** of consumer credit products is not regularly provided. Non-bank loan providers are more likely to overlook verification of the suitability of the credit product being sold.

The EBA has identified poor CWAs as one of the main trends in consumer credit across the EU, highlighting the low levels of information on the customers' financial circumstances as a key driver in this area. Poor selling practices, for example, high and non-transparent fees on revolving credit facilities have also been highlighted by the EBA.

In addition, practices leading to mis-selling and irresponsible lending are more common in the digital consumer credit market. This is significant in the context of the COVID-19 pandemic, where many consumers are conducting their end-to-end journey through digital channels. The Commission released the findings of a review of websites advertising and selling consumer credit in April 2021. The review identified a number of trends including a lack of transparent advertising of interest rate and cost of credit through a representative example and unclear information regarding how CWAs are performed. This has been further highlighted by the EBA, who identified poor transparency in digital channels as one of the main trends in consumer credit across the EU.

Recommendations

The following is a high-level summary of the Finance Watch's recommended revisions to the CCD:

- Implement rules on **content, presentation and format of pre-contractual information.** Finance Watch recommend that timelines are introduced for the provision of pre-contractual information (e.g. at least 48 hours before the consumer concludes a credit contract). This has also been considered by the Commission;
- Implement detailed rules on **content, presentation and format of information included in advertising** and introduce a requirement for credit providers to include a warning that credit costs money. Unsolicited advertising should be banned, which has also been considered by the Commission;
- Changes to the **requirements associated with an adequate CWA** have been considered by the Commission. Finance Watch have made a number of recommendations as follows:
  - Specific information requirements for the completion of CWA should be set out;
  - Sales of consumer credit should be refused if the CWA shows that the consumer cannot afford the loan, protecting vulnerable customers; and
  - A requirement should be added to provide consumers with an adequate explanation of the basis on which a decision regarding their creditworthiness was reached.
- The scope of the CCD should include activities of **non-bank entities**. Additionally, all non-bank entities should be subject to a registration and supervision process;

- Similar to the Commission's public consultation and in light of increased digitalisation of the market and the new categories of vulnerable customers emerging as a result (e.g. the digitally disadvantaged), **provisions specific to the online consumer credit market** should be introduced:
  - Pre-contractual information to be provided by digital means prior to the conclusion of a credit agreement; and
  - Clear rules on how pre-contractual information should be presented to consumers in a digital environment.
- **The scope of the CCD should be widened** to include:
  - Consumer credit under €200 (e.g. payday loans). This is also considered by the Commission; and
  - Caps on APR to protect vulnerable consumers from unreasonable costs.

(Please note, in Ireland the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Licensed Moneylenders) Regulations 2020 brings loans under €200 into scope and requires a high cost warning where APR exceeds 23%)

- Introduce obligations for manufacturers of consumer credit to define a **target market** when designing a product and ensure the products are sold to that target market only. In addition, in line with the Mortgage Credit Directive, standards on the provision of advisory services to consumers should be introduced.

While a number of additional consumer protection measures are in place at a national level for those outside the scope of the CCD, the introduction of increased protections at an EU level will require a significant change in lending practices and will impact processes, systems and people. It is anticipated that the study conducted by Finance Watch will encourage discussion in the area of responsible lending, particularly in relation to proposed updates to the CCD currently being considered by the Commission as a result of its public consultation.

Next Step - Adoption

It is anticipated that the Commission will adopt any updates to the CCD from its public consultation in 2021.

How can KPMG help?

KPMG's Consulting experts in the conduct, regulatory and financial services sectors have unparalleled experience assisting financial institutions with conduct risk reviews and regulatory implementations. We have extensive experience in guiding organisations through regulatory change and designing and implementing your operating policies, procedures and systems to align to the requirements. We have designed methodologies that will help you during the process. Examples of how our team of experts can assist include:

- Support you in establishing a programme of work to address the changes required as a result of the new requirements;
- Assist you with a gap analysis, assessing the changes which will be required to be adopted, including any scope changes for lending that are currently not covered by CCD;
- Advise you on the design of any changes required and how these changes impact your organisation across people, processes and technology;
- Assist you with the testing of the changes to ensure that they are adequately designed pre implementation;
- Assist you with implementation and post-implementation assessment ensuring that the changes were applied correctly and in line with the new regulatory requirements; and
- Support you in training your staff following the changes through a variety of training techniques.

It is important to maintain oversight of your lending products post regulatory implementation to ensure continued adherence to these requirements. We have an established product assurance framework, which will arm you with tools and techniques to control your product set on an on-going basis, maintain regulatory compliance and enable positive customer engagement. For more information on the product assurance framework, visit our website:

Product Assurance - KPMG Ireland (home.kpmg)

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