

ZENTRALER KREDITAUSSCHUSS

MITGLIEDER: BUNDESVERBAND DER DEUTSCHEN VOLKSBANKEN UND RAIFFEISENBANKEN E.V. BERLIN • BUNDESVERBAND DEUTSCHER BANKEN E. V. BERLIN • BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E. V. BERLIN • DEUTSCHER SPARKASSEN- UND GIROVERBAND E. V. BERLIN-BONN • VERBAND DEUTSCHER HYPOTHEKENBANKENE. V. BERLIN

Comments of the Zentraler Kreditausschuss¹

**on the revised draft of the European Commission for an amendment of
"the Directive on the harmonisation of the laws, regulations and
administrative provisions of the Member States concerning credit for
consumers"
- Consumer Credit Directive -**

¹ The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Hypothekenbanken (VdH)*, for the mortgage banks. Collectively, they represent more than 2.500 banks.

Table of Contents

	Page
A. Introduction	5
B. General	6
C. Comments on the individual provisions	7
I. Re. Art. 2 – "Definitions"	7
1. Art. 2 e) – "Surety agreement"	7
2. Art. 2 g) – "Total amount of credit"	8
3. Art. 2 o) – "Durable medium"	8
4. Art. 2 – "Linked credit agreements"	9
II. Art. 3 – "Scope"	10
1. "Light Regimes"	10
• Smaller loans	10
• Loans with a general interest purpose	11
• Credits for refinancing debts	12
2. Continued validity of the hitherto valid exemptions for advances on a current account	13
3. Continued validity of the amount threshold for applicability of the Directive	14
4. Exemption of authentic acts signed before a notary or judge	14
5. Exemption of sureties from the scope of the Directive	15
6. Exemption of credit agreements secured by mortgage on immovable property	17
III. Art. 5 – "Ban on negotiation of credit and surety agreements outside business premises"	18

IV. Information obligations	19
V. Art. 5 – "Responsible lending"	20
1. Credit assessment	20
2. Need for greater specification of the disclosure obligation of the consumer	21
3. List of information requirements in Art. 5 paragraph 2 a) to l)	22
4. Possibility for compliance with "Pre-contractual information by handing out a draft agreement"	23
5. "Establishing the most appropriate type and total amount of credit – Need to delete Art. 5 paragraph 4 CCD Proposal	23
VI. Art. 7 – "Access to data bases"	25
VII. Art. 10 – "Information which shall be included in the credit or surety agreement"	25
1. No possibility for credit institutions to disclose all costs	25
2. Possibility to conclude agreements in an electronic form	26
VII. Art. 11 – "Right of withdrawal"	27
IX. Art. 14 – "Borrowing rate"	27
1. Possibility for credit institutions to adjust the borrowing rate of the credit based on changed refinancing possibilities in the money and capital market	27
2. Changes in the wake of the new Basel Capital Adequacy Accord ("Basel II")	28
X. Art. 16 – "Right of early repayment"	29
XI. Art. 19 – "Linked transactions"	31

XII. Art. 21 – "Credit agreement in the form of an advance on a current account or a debit account"	32
XIII. Art. 22 – "Open-end credit agreement"	32
XIV. Art. 23 – "Performance of the surety agreement"	34
XV. Art. 24 – "Default notice and enforceability"	35
XVI. Art. 25 – "Overrunning the total amount of credit and tacit overdrafts"	35
XVII. Art. 31 – "Penalties"	36
.	
XVIII. Art. 34 – "Existing agreements"	36

A. Introduction

On 11 September 2002, the European Commission submitted its first "Proposal on 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" amending the Directive "for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit" of 22 December 1986 – last amended by Directive 98/7/EC of 16 February 1998². After this initial Proposal for an amendment of the consumer credit legislation met with strong criticism, on 28 October 2004 the Commission tabled a revised draft. Yet, *in lieu* of submitting one consolidated Proposal text with the full wording, the Commission merely submitted some kind of Annex commenting the amendments adopted by the European Parliament. Hence, the structure and the numbering of the Directive are partly intransparent or, moreover, still need to be finalised. What is more, when aggregated, the combination of the initial text of the Directive, the parliamentary amendments and the comments added by the Commission give rise to a considerable degree of confusion creating several issues which are difficult to comprehend. Through this kind of approach, the Commission not only creates considerable uncertainties. What is more, it makes it far more difficult for all interested parties to clearly and unambiguously identify their position in the ensuing consultation round. Furthermore, we have considerable doubts as to whether the legal nature of the text really qualifies for a new Commission Proposal or whether this text should merely be regarded as a preliminary working document of the Commission which would have to be followed by a consolidated version. This question also comes to mind because, according to Commission sources, the submitted amendments were not to be regarded as a formally amended, new Proposal. Hence, we would like to strongly urge the Council to turn down the draft submitted by the Commission and to call for the publication of one coherent and complete Proposal for a Directive on Consumer Credit by the Commission before starting its consultations.

Notwithstanding the foregoing reservations and based on our preliminary understanding, we would like to submit the following comments on the proposed amendments tabled by the European Commission. Yet, at the same time we should like to point out that our comments have a preliminary nature and that we reserve the right to make potential additions and corrections as soon as a consolidated and revised Proposal for a Directive has been submitted.

² ABI. EG No. L 101 1998, p. 17 – 23.

B. General

The amendment of the Consumer Credit Directive is aimed at enhanced consumer protection; it notably seeks to address the issue of excessive consumer debt. Yet, despite the fact that there have been some improvements over the initial Proposal the Commission Proposal fails to achieve this objective. This is due to the fact that, in large parts, the Commission Proposal is still removed from practice and because, in effect, it remains unbalanced.

One key problem of the Proposal remains that it abolishes the principle of personal responsibility on the part of the consumer for his borrowing decisions. Yet, any kind of investment is associated with an economic risk; assuming this economic risk on behalf of the client is simply not possible for a financing credit institution. It shall and must not be the goal of European legislation to protect the consumer from himself and to provide him with an opportunity to roll over the economic consequences for his actions to the credit institution. The creation of provisions, which in effect give the client the impression that he can take decisions without having to personally carefully weigh the pros and cons, where, in the final analysis, the client shall not be personally accountable for these decisions, sends out wrong signals to the client and will absolutely not lead to a situation which will allow clients to take careful and personally responsible decisions. Yet, these are decisions which, for instance in the field of old age provisions, consumers are absolutely expected to take. The banking industry obviously advocates that when signing a loan agreement, the borrower shall be informed about the content in a way that will allow him to take an informed choice as regards his credit. The information obligation must, however, not go to an extent where the consumer be overwhelmed by an information overkill. After all, this would be counterproductive with regard to the envisaged transparency for the purposes of consumer protection.

Furthermore, the proposed provisions would subject consumer credits in Europe to comprehensive formalities. This would create an unnecessary amount of red tape and more complex processing. For the consumer, this would not only result in a significant rise in the cost of lending but also in restrictions with regard to lending in general.

In its report³, the European Parliament and notably the competent Committee for Legal Affairs and the Internal Market had already submitted balanced solutions for a number of the critical issues contained in the Proposal which would have taken adequate account of the interests of the various stakeholders. Yet, from crucial comments, the Commission only adopted individual suggestions.

Successful amendment of the Consumer Credit Directive now hinges on the European Council which is called upon to implement fundamental changes.

C. Comments on the individual provisions

I. Re. Art. 2 – "Definitions"

1. Art. 2 e) – "Surety agreement"

The unamended Article 2 e) of the CCD Proposal refers to the "surety agreement" as an "accessory" agreement by which a guarantor guarantees or undertakes to guarantee performance of a credit agreement. Contrary to this, in the initial proposal's recital which will probably still be valid in this regard, it is pointed out that the scope of the Directive shall cover "all sureties, both personal and in material form" which a consumer provides in return for a credit⁴.

Concerning the recital's statement it does, however, still remain unclear whether Art. 2 e) of the CCD Proposal – as is suggested by the wording – only covers sureties which are "accessory" as contemplated by German law, i.e. where their existence depends on the claim under the law of obligations or whether – as is envisaged by the Directive's recital – the scope of the Directive shall cover each and any surety, i.e. also non-accessory sureties. Regardless of these uncertainties in terms of the nomenclature, there are also more general, wider concerns as to an extension of the scope of the Consumer Credit Directive to also include surety agreements. For a more detailed discussion cf. the presentations under Art. 3 (cf. II.5). Should, despite our foregoing reservations, plans to include surety agreements under the scope of the Directive not be abandoned, then we at least recommend synchronising the recital and the Directive's language under Art. 2 e). This

³ Second report on the Proposal for a Directive of the European Parliament and the Council for the harmonisation of the laws, regulations and administrative provisions of the Member States concerning consumer credit of 02 April 2004 (A5-0224/2004).

⁴ Explanatory Memorandum of the Proposal for a Directive, p. 10.

would necessarily require a restriction of the regulatory scope to accessory sureties, the reason being that the latter, after all, are at least still linked in a special manner with the credit agreement.

2. Art. 2 g) – "Total amount of credit"

The 2004 Commission Proposal contains a new definition of the "total amount of the credit". This new definition essentially presents an improvement over the term of the "total cost of credit" contained in the current Directive (98/7/EC). Under the definition proposed in the 2004 Proposal, this term would cover such costs which are known to the creditor and which the creditor shall thus be capable of indicating. We subscribe to this proposed definition. Unfortunately, however, this proposed definition is inconsistent with the provisions on pre-contractual information requirements which are equally contained in the 2004 Proposal. (Article 2 h) calls for disclosure of costs payable by the consumer on conclusion of the credit agreement to persons other than the creditor or the credit intermediary, regardless whether these costs are known). Hence, the foregoing inconsistency results in an inconsistency within the overall information requirements regime proposed under the 2004 Proposal.

Furthermore, it is problematic that there is no clear specification of the term of "ancillary service relating to the credit agreement" ("Nebenleistung" in the German language version). Due to the lacking terminological specification, it remains unclear which services are specifically covered by this provision. This problem is further compounded by the circumstance that the German language version is inconsistent: Under item h) concerning pre-contractual information, the German text digresses from the standard terminology and uses the term "Nebendienstleistung" instead of "Nebenleistung". This is not the case in the English language version. The English language version consistently refers to one single term ("ancillary services"). In order to prevent misunderstandings, also the German language version should make consistent use of the same terminology.

3. Art. 2 o) – "Durable medium"

It is our understanding, that agreements may also be finalised in an electronic form. In order to clarify this point beyond any doubt, it would be helpful if the definition of a durable medium would also specifically list the possibility of concluding agreements in an electronic form as an option i.e. if the definition of a durable medium were to clarify that an agreement may not only prepared in an electronic form but that it may also be concluded in an electronic form (cf. VII.2.).

4. Art. 2 – "Linked credit agreements"

In its 2004 Proposal, the Commission includes a definition of a linked transaction. This is problematic on two counts.

First, the definition is in need of substantial further clarification. The wording of the proposed definition is modelled on the provision contained in the German Civil Code, section 358, paragraph 3 (1) and (2). Yet, without any further clarification this specification is not concise enough to clarify the scope of the provisions on "linked agreements". We propose that agreements shall only qualify for treatment as "linked credit agreements" if and when the underlying transaction and the agreement concluded for the funding of this transaction are inextricably linked in a cause-and-effect relationship. In other words: if neither agreement would have been concluded in the absence of the other agreement and if the conclusion of either agreement is the *conditio sine qua non* for the rationale behind concluding the other agreement. We propose that only such agreements shall qualify for treatment as a "linked credit agreement". Our recommendation is based on general market practices and it is also in line with the consistent rulings of Germany's Federal Court of Justice (cf. e.g. BGH NJW 2000, 3065, 3066 as well as the legal commentary of Habersack in the Munich commentary for the Civil Code, 4th ed., section 358, recital 36).

Utmost care is required when transposing into EU law the definition contained in section 358, paragraph 3 (1) and (2), German Civil Code of Justice. There need to be safeguards, so that said clarifying law issued by Germany's Federal Court of Justice will not become 'lost'. An 'abridged' definition of the term 'linked credit agreement' under European law shall and must not result in a boundless proliferation of the term "linked credit agreement". This would constitute a massive extension of the liability regime to the detriment of banks.

Second, the legal implications of linked transactions as contained in the provisions are not easily understood. The Directive only regulates cases where the client withdraws from the purchase agreement for which he has taken out the credit. The Directive stipulates that withdrawal from the purchase agreement shall warrant withdrawal from the credit agreement. The text, however, remains silent on the opposite case, i.e. it contains no provisions on withdrawal from the credit agreement. As a result, there is an incomprehensible asymmetry of the regulation. Here, the Commission merely refers to the principles which have already been defined under Article 11 of the current Consumer Credit Directive (the consumer's right to enforce claims *vis à vis* the creditor) pointing out that these had been transposed into national law and that there should be

continued consideration thereof. How this request – which, at this juncture, is only contained in the comment – should be implemented in the long run, is unclear.

II. Art. 3 – "Scope"

1. "Light Regimes"

Contrary to the first Proposal from the year 2002, the current Proposal envisages a restricted applicability with regard to credits below EUR 300, general interest loans and refinancing loans,. Under the Commission's new Proposal, these loans would become subject to a "light regime" for pre-contractual and contractual information. The provisions on this 'light regime' are contained under Article 7 of the CCD Proposal. In this context we would like to explicitly point out that the aforementioned – albeit reduced – information requirements for the respective credits are excessive and partly not feasible in practice. Furthermore, the amended version does not clarify that said specific loans shall 'merely' fall under this 'light regime' in terms of their information requirements; it fails to spell out, that apart from this 'light regime' for information requirements, said loans shall be exempt from the Directive's scope. Article 3 of the present Proposal could also be construed as meaning that – in addition to the information obligations pursuant to Article 7 CCD Proposal – the rest of the Directive would fully apply. Hence, we feel an urgent need for a clarification that credits below EUR 300, general interest loans and refinancing loans as contemplated by the CCD Proposal shall not fall under the full scope of the Directive but that they shall only be subject to a light regime.

- **Smaller loans**

With regard to smaller loans as contemplated by the CCD Proposal, even the "light" information requirements and the resulting processing effort with its corresponding costs would bear no relation to the revenue generated. In the final analysis, any extension of the CCD's scope to include such credit agreements would have to be borne by the consumer. Apart from this, the CCD's rationale is consumer protection. It remains doubtful whether smaller loan amounts of up to EUR 300 will severely touch upon consumer protection interests. What is more, neither the recital of the Proposal nor the European Commission's report on application of the existing Directive highlight any difficulties which might have occurred under the present de minimis regime hitherto contained under Art. 2 f) CCD which would justify such an amendment. We therefore propose maintaining the exemption clause for de minimis loans as contained under the present Directive.

- **Loans with a general interest purpose**

The present Proposal for a Directive proposes not to exempt completely general interest loans from scope of the Directive. This is in contrast with the provisions envisaged under the Commission Proposal dated September 2002. It is also in contrast with the European Parliament's request, which had asked for a complete exemption of general interest loans from the scope of the Directive. We endorse this request because the information requirements envisaged under Article 7 (new) do not take adequate account of the peculiarities inherent in these credits. Hence, we propose to completely exempt general interest loans from the scope of the Directive.

In order to promote university training and vocational training, Germany has a system of government grants which are extended in the form of loans. This policy is subject to public-law and it is ruled by the applicable national legislation (German Law on Education and Training Promotion (BAFöG) and the Law on promotion of the vocational career development scheme (AFBG). Once their eligibility for these loans has been approved under a public-law procedure, eligible clients then receive a legal title to conclude private-law agreements with special credit institutions (general interest loan banks). Therefore, whilst these loans are extended by general interest loan banks, eligibility for such loans is examined by civil servants. Due to the public law nature of this procedure, the various civil servants will not be in a position to meet the – albeit lighter – information requirements under the present proposal (cf. sections 17, paragraph 3, 18 c and d, 50 BAFöG and sections 12 and 13 AFBG). Determining the total amount of credit or the maturity at the point in time when the eligibility of the client is examined and the credit is approved, is not possible. This is due to the fact that the latter may be contingent on various factors which lie in the future and which are predicated on the borrower himself. For instance, in the promotion under the German BaFöG scheme, the maximum entitlement period and hence the maximum amount of benefits that have to be provided are based on the student's length of studies and also on the current income trends of the parents' income. This data is being reviewed in regular intervals. Whenever changes occur, the BAFöG benefits will be adjusted accordingly over a specified period. Furthermore, concerning the obligation to disclose the "term to maturity of the credit" (Article 7 CCD Proposal), we should like to point out a peculiarity of the German BAFöG and AFBG loans: In Germany, BAFöG and AFBG loans feature the possibility of fixing the interest rate as of the beginning of the repayment period. The fixing of the interest rate is at the discretion of the grantee, i.e. it is optional. Generally, the repayment period begins several years after the training scheme has ended. There is a minimum rate for repayment and there is a maximum time to maturity. Due to these two parameters which will only become available once

the repayment period starts, a credit's exact term to maturity can therefore only be established once the repayment period begins. And such repayment period generally only begins a long time after conclusion of the general interest loan. Hence, the only parameters which may realistically be disclosed at the time of signing the general interest loan, are those variables which could potentially become relevant for fixing the term to maturity of these general interest loans. Yet, for the consumer this would not constitute meaningful information. For promotion credit, no specific data could possibly be disclosed. This is due to the fact that the term to maturity of this form of general interest loan would be contingent upon future factors which are still uncertain.

Borrowers who are eligible for general interest loans have a legal title. Should the amended Commission proposal exceed the mere information requirements pursuant to Article 7 CCD Proposal, then a provision with regard to responsible lending would become completely redundant. What is more, it is even in line with the general interests of broader economic and educational goals and in line with the interests of the potential borrower, that such general interest loans be extended without regard to the borrower's creditworthiness. In the case of general interest credits which are backed by the state, there is no need to protect the consumer from this very state. Hence, it would be inappropriate to burden general interest credit institutions with comprehensive obligations; it would be inappropriate to roll over the resulting higher costs to general interest borrowers or, respectively, to Germany's central or local government level (the latter have to cover the default risk for BAFöG or AFBG loans extended by the general interest credit institutions). In addition to this, such cost increase would also have a knock-on effect on the area of loans for environmental purposes or modernisation.

Furthermore, it needs to be pointed out that neither the obligations which result from the provisions of the Consumer Credit Directive nor the simplified information requirements pursuant to a new Article 7 take adequate account of the peculiarities of general interest loans. In order to ensure the continued existence of general interest loans which are presently offered in Germany at favourable conditions and where eligibility for such loans is examined in a consumer friendly manner, we therefore propose to completely exempt general interest loans from the scope of the information requirements contained in the current CCD Proposal.

- **Credits for refinancing debts**

We equally object covering credits for refinancing of existing debts, under the scope of the "light regime" stipulated by the current Proposal. Unless the Commission were to drop its proposal to include credits for refinancing debts under the scope of the Directive we still strongly oppose presenting clients with a new – albeit less comprehensive – draft agreement as contemplated by

the Commission proposal. Our objection is due to the fact that this would be pointless under the given circumstances: The consumer will invariably have to talk to one of the bank's customer advisers, anyway. Hence, *in lieu of* introducing a new draft agreement which – particularly for the customer – would not add to more transparency, it would make more sense to conclude a regular new consumer credit agreement in the usual form. What is more, a further draft agreement would unnecessarily add to the potential error sources for client advice and could also give rise to misunderstandings.

2. Continued validity of the hitherto valid exemptions for advances on a current account

Contrary to plans in its initial Proposal, the Commission also seeks to include overdrafts under the scope of a "light regime" as contemplated by Article 6 CCD Proposal. This is to be welcomed if and when this should *de facto* mean that the Directive for the rest shall not be applicable at all. In this regard, however, there are considerable uncertainties. We would only like to mention the smaller loans and general interest loans. Under Art. 2 paragraph 1 e), the existing Directive contains a provision pursuant to which the Directive's formal requirements concerning overdrafts shall not be applicable to overdrafts granted on current accounts. The current Proposal seeks to ensure an adequate level of consumer protection with regard to overdrafts granted on current accounts by stipulating a special information regime in the form of a list of mandatory information requirements for credit institutions which grant overdrafts on current accounts, Article 6 CCD.

Yet, these information requirements are a source of concern since they stipulate the binding obligation to present a representative example of the annual percentage rate of charge. Our concerns over this new requirement are due to the fact that the new provision leaves completely open what such an example might look like. Furthermore, within the framework of the account statement, it will be difficult to present this calculation example in a meaningful format and to avoid potential confusion or misunderstandings on the part of the client. Unless plans to introduce this requirement were to be dropped, the requirement to present the client with a representative calculation example in the course of the account statement would endanger overdrafts as a credit product and at the same time as a simple and unbureaucratic form of providing liquidity. This is due to the fact that compliance with such a provision would clearly not feature a reasonable cost-benefit ratio. Overdraft facilities are an essential product for short-term credit requirements, such as, for instance, a direct debit by a utility company for gas, water and electricity invoices before the client's pay-check has cleared. Yet, they could no longer be offered at competitive rates under the planned provision contained under Article 6 of the Commission's Proposal. Furthermore, due to the differences in the term to maturity in combination with the host of different applications, it

will be very difficult to come up with a truly representative example for calculation of the annual percentage rate of charge.

In addition to this, experience over the past years and decades has shown that the "information model" as contemplated by Art. 6 of the current Directive 98/7/EC (now Art. 21 CCD Proposal) provides a sufficient degree of consumer protection.

3. Continued validity of the amount threshold for applicability of the Directive

Pursuant to Art. 2 paragraph 1 f), the present CCD shall not be applicable to credit agreements which amount to "more than 20 000 ECU". In its current proposal, the European Commission now suggests raising this threshold to EUR100,000 (Art. 3 i)).

Up to a certain point, we subscribe to the European Commission's view: consumer credit agreements absolutely also occur above the present threshold and it may be worth reviewing this threshold. Yet, the threshold of EUR100,000 which has now been fixed, is too high. Firstly, loan amounts of this dimension generally indicate an economic experience on the part of the borrower. Hence, cases where such amounts are involved do not necessarily indicate a special need for consumer protection which is the Directive's centrepiece. What is more, it is especially those alleged 'consumers' who, in practice, tend to oppose the formal provisions under the Consumer Credit Directive: Officially, they might be regarded as "consumers" but at the same time, they are in possession of a considerable amount of economic experience and feel the need for large credit volumes. These persons tend to feel patronised and they also tend to regard such provisions as an "excessive and incomprehensible creation of red tape for the lending business" and as an "obstacle for loan extensions".

Hence, whilst we basically agree with a review of the threshold for applicability of the Consumer Credit Directive, the only reservation we have to make in this context is that we propose to essentially keep the maximum threshold as contemplated by Art. 2 paragraph 1 f) of the Directive, yet to merely adjust its level to EUR 50,000 maximum.

4. Exemption of authentic acts signed before a notary or judge

If a credit agreement is authenticated by a notary or any other sovereign body, then this agreement shall be subject to the rules and regulations concerning form applicable with regard to the authenticating authority. Therefore, such agreements as contemplated by Art. 2 paragraph 4

of the current CCD may be exempt from the scope of the forthcoming CCD. The same applies to credit agreements in the form of "authentic acts signed before a judge".

Yet, the revised Proposal merely maintained an exemption for the latter. Yet, there is a compelling need to maintain both derogations. This need is also, but not exclusively, due to very practical reasons: Neither courts – for instance when there is a court settlement – nor notaries will generally be in the least capable of calculating and disclosing the information requested under the CCD (suffice it to mention the "annual percentage rate of charge" or the "costs" etc). We therefore propose to keep said scenarios exempt from the scope of the forthcoming CCD.

5. Exemption of sureties from the scope of the Directive

Pursuant to Art. 1 in combination with Art. 3 paragraph 1 of the CCD Proposal, the forthcoming Directive's regulatory scope would also include "surety agreements" (cf. our foregoing presentations under I. concerning Art. 2 e) CCD Proposal). Pursuant to the Commission Proposal's recital the forthcoming Directive shall cover "all sureties, in both personal and material form: bonds, joint and several liability, mortgages and sureties etc.". Such an extension of the CCD's regulatory scope to include credit sureties gives rise to fundamental concerns.

This amendment is motivated by the Commission's goal of ensuring that consumers who stand credit surety (guarantors) should be entitled to the same level of information and consumer protection as consumers who take out a credit (borrowers⁵).

Whilst this is a valid motivation, it fails to take adequate account of the fact that the loan agreement on the one hand and the surety agreement on the other hand are driven by two entirely different economic goals; therefore, guarantors and creditors will not have 'comparable' interests and a comparable need for protection in each and every case. Subsuming both contractual relations under the regulatory scope of the principle of "responsible lending" despite their different natures, would therefore be neither feasible nor appropriate (for a more detailed discussion cf. our presentations below on Article 5 CCD Proposal). Since the guarantor will generally not have the same need for information as the creditor, the obligation to provide him with comprehensive information regardless of his actual needs would hence only generate unnecessary costs.

⁵ Explanatory Memorandum of the Proposal for the CCD, page 11

Besides, the providers of surety are already sufficiently protected through special rules on the content of the respective credit sureties. For German law, by way of example, we should therefore like to refer to the rulings on sureties issued by Germany's Federal Court of Justice. Over the past years, following the decision of the Federal Constitutional Court dated 19 October 1993⁶, the latter have consistently strengthened the legal status of the guarantor. When assessing whether there is a violation of *bonos mores* of sureties pursuant to section 138 paragraph 1 Civil Code, Germany's Federal Court of Justice already nowadays takes it that *de jure*, sureties will generally consist in a unilateral obligation to the benefit of the creditor and that it hence cannot feature an appropriate and basically equivalent consideration of mutual interests. Instead, there is an understanding that, in its legal core, it is aimed at providing only one side with benefits.⁷ Based on this principle, Germany's Federal Court of Justice has subsequently consistently expanded the case law protecting the guarantor from excessive demands that would violate *bonos mores*.⁸ In Germany, this guarantor protection is complemented by an "Anlass-Rechtssprechung" i.e. a jurisdiction "predicated on the underlying transaction". Pursuant to this "Anlass-Rechtssprechung", the liability assumed by the guarantor shall not extend to all present and future liabilities (broad surety purpose) but extends specifically to the liability which is the motivation for the surety (narrow surety purpose).⁹ What is more, for quite some time now, German credit institutions have already been taking account of these requirements for a longer period of time because they now only accept sureties with a narrow surety purpose from private persons; the latter generally have a cap in the form of a maximum threshold. The agreed maximum amount of the surety refers to the maximum amount which can be drawn upon. Exceeding the maximum amount due to potential accessory claims shall not be possible. Furthermore, the consumer – just like with other permanent debt obligations – shall regularly have the right to terminate an undated surety with the consequence that the guarantor shall only be liable for the debtor's liability towards the credit institution if and when such liability existed at the time when the termination came into effect.

Given the foregoing, the protection of the guarantor in connection with material sureties is similarly pronounced. The creation of complementary provisions under the law on credit agreements would therefore not be justified by a corresponding protection need and it would furthermore inevitably lead to inconsistencies within the system which should be absolutely prevented. Furthermore, it would make the legal application more difficult.

Also in future, the scope of application of the Consumer Credit Directive should therefore remain limited to consumer credits.

⁶ WM 1993, p. 2199 ff.

⁷ BGH WM 1994, p. 676, 677.

⁸ Cf. e.g. BGH WM 1997, p. 467 ff. as well as BGH WM 2000, p. 23 ff.

⁹ BGH WM 1995, 1397, 1401 f.

6. Exemption of credit agreements secured by mortgage on immovable property

Under Art. 3 paragraph 2 a) the Commission Proposal contains a derogation for loans secured by mortgage on immovable property if and when these serve to "purchase or transformation of private immovable property" which belongs to the consumer or which he plans to acquire. This derogation which was adopted from the initial Proposal takes account of the Code of Conduct for home loans agreed at the European level between the financial service sector and consumers. A Code of Conduct, which the European Commission supports through its recommendation dated 1 March 2001 on "pre-contractual information which have to be provided to the consumer by creditors offering home loans"¹⁰,

In the course of the deliberations at a European Level which have now been going on for two years concerning the CCD Proposal, individual countries (notably also the new eastern European Member States) have made deliberations to also include credits secured by mortgage on immovable property under the scope of the Directive. Such an approach is unacceptable: Over the past 3.5 years, in order to turn the Code of Conduct which is the result of three years of continuous negotiations between the financial services sector, the consumer side and the Commission into a success, the banking industry – and when we refer to the banking industry at this juncture, this term shall refer both to German credit institutions as well as other European credit institutions which have subscribed to the aforementioned Code of Conduct *vis à vis* the European Commission (cf. list on the internet under http://europa.eu.int/comm/internal_market/finservices-retail/index_en.htm) – the banking industry has implemented said recommendation of the Commission whilst undertaking considerable investments and making a major effort. In connection with the publication of its recommendations, the European Commission has repeatedly promised to keep the mortgage loan sector exempt from the scope of the Consumer Credit Directive provided that the Code of Conduct is being accepted in practice by European credit institutions. It is hence absolutely unjustified to now undermine the efforts which have been undertaken over the past years by including home loans under the scope of the Directive. A derogation for loans secured by mortgage on immovable property must therefore be maintained by all means.

This derogation should furthermore extend to each and any loan secured by mortgage on immovable property, i.e. regardless of the purpose for which the borrowed funds will be used. Such loans should entirely (and not only conditionally, i.e. if and when they serve the purposes of

¹⁰ ABI. EC No. L 69 2001, p. 25 – 23.

financing home ownership) fall under the scope of the Code of Conduct. Such an approach appears preferable already because a credit institution in practice – if at all – only has limited control over the use of the funds and – both in Germany and also in other European countries – there are partly "mixed financing schemes" where the funds borrowed may primarily serve the purposes of home finance but a smaller maximum amount may indeed simultaneously serve for acquisition of consumer goods (e.g. purchasing a passenger car).

Furthermore, in connection with loans for debt refinancing (i.e. loans which frequently occur in the context of financing schemes secured by mortgage on immovable property), a differentiation based on the purpose would lead to practical difficulties. Pursuant to the language contained under Art. 3 paragraph 2 a) CCD Proposal, such loans would not be immediately covered by the scope of the Directive. Yet, even predicating this provision on the use of the original loan would frequently be no solution either. Often, over the years, there will be several instances of debt rescheduling and/or aggregation of claims meaning that in the end a simple and safe allocation to one specific underlying loan will no longer be possible. In cases where rescheduling is also associated with a change of the creditor, predication on the original loan will anyway be out of the question. Including such loans for refinancing generally under the scope of the Directive would however not be appropriate and is potentially not the Commission's intention, either.

Last but not least in connection with the language chosen in the Proposal it remains unclear whether the borrower himself has to be identical with the owner of the respective real property or whether such owner may also be a third party. Contrary to the English text, the German text refers to the indefinite article ("... die im Eigentum eines Verbrauchers steht..."). This indicates the latter interpretation; theoretically, the German text would, however, also allow a different interpretation.

In effect, it would therefore be appropriate to exclude loans secured by mortgage on immovable property regardless of their use entirely from the Directive's scope of application. Instead we propose subjecting them to the scope of the Commission's recommendation.

III. Art. 5 – "Ban on negotiation of credit and surety agreements outside business premises"

We welcome the deletion of Art. 5 CCD Proposal which aimed at banning any negotiation of credit and surety agreements outside business premises under those circumstances described in Article 1 of the Directive 85/577/EEC.

The rationale for such a ban on credit or surety agreements negotiated away from business premises was unclear, anyway: Art. 1 of the Directive 85/577/EEC (COUNCIL DIRECTIVE of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises) provides the consumer with a right of revocation for all contracts negotiated away from business premises as contemplated by its regulatory scope. This approach creates a cooling-off period which adequately reflects the peculiarities inherent in contracts negotiated away from business premises.

In its various rulings, the European Court of Justice has clarified that this Directive shall be applicable to both credit agreements¹¹ and to surety agreements¹². At a national level, also Germany's Federal Court of Justice has confirmed the applicability of the implementation standards within the framework of the German jurisdiction to credit agreements¹³ and sureties¹⁴. Yet, given the fact that the consumer is however, both at a European level and also at a national level, already sufficiently protected through the provisions of the Directive on contracts negotiated away from business premises or under sections 312 ff. German Civil Code then there is no justification for the far-reaching ban on contracts negotiated away from business premises stipulated under Art. 5 of the Commission's Proposal for a CCD. The resulting disadvantages for the banking industry would therefore be devoid of any objective basis.

IV. Information obligations

Based on the information requirements proposed by Parliament, the new Commission Proposal now makes a distinction between three different levels of consumer information:

- standard information in advertising (Art. 4),
- pre-contractual information requirements (cf. below on Art. 5),
- contractual information requirements (cf. below on Art. 10).

Since this would lead to duplication and inconsistencies in client information (cf. e.g. above under I.2. on Art. 2 g) CCD Proposal) and since it would also generate an information overkill for the client regardless of the individual information requirements themselves, during the ongoing discussions, the banking industry has repeatedly criticised this spread of the different information requirements across the Directive. The consumer would no longer be in a position to comprehend

¹¹ European Court of Justice (Heininger./ Bayerische Hypo- und Vereinsbank AG) WM 2001, pp. 2434 ff.

¹² European Court of Justice WM 1998, pp. 649 ff.

¹³ BGH WM 2002, pp. 1181 ff.

¹⁴ BGH WM 1993, pp. 683 ff. as well as BGH WM 1995, pp. 2027 ff.

and gauge the full meaning of the piecemeal information featuring different degrees of detail at the various levels. This would, in effect, be counterproductive with regard to the overarching goal, i.e. providing consumers with an opportunity to make an informed choice.

With a view to third party costs (notaries, land registries, fiscal authorities etc.) there should always be a clarification for all levels of information that these shall only have to be disclosed if and when they are indeed known to the creditor. These costs could often only be quantified if institutions went to great lengths in order to establish them or they may only be estimated. The costs which would be created for the institution would eventually have to be borne by the consumer in the form of higher costs for credits. The consumer must however be given an opportunity to decide for himself whether he wishes to use this service of the institution and whether he is prepared to pay for this or whether he wants to obtain the corresponding information by himself.

V. Art. 5 – "Responsible lending"

There are plans to essentially keep the principle of "responsible lending" which was already contained in the initial Commission Proposal under Article 9 CCD Proposal. Having said this, the principle of "responsible lending" is now being introduced in the part on pre-contractual information (cf. Article 5 of the Commission Proposal).

Through the proposed provision, the credit law would see an introduction of extended information and consultation obligations at the expense of the (potential) creditors whilst, on the other hand, the personal responsibility of the consumer would be neglected. More specifically, we would like to highlight the following issues in this regard:

1. Credit assessment

Already today, the decision on lending is taken in a responsible manner by credit institutions. Notably the client's creditworthiness is already being carefully assessed by the institutions. This is already due to credit institutions' own vested interests because they want to largely ensure that there will be no instance of default for the institution when it comes to paying back the loan. Credit institutions carry out reviews; they do this last but not least in order to meet their obligations under prudential supervision law but also in their own vested interests. Yet, these reviews must not be expanded to a degree where in future the decision on whether taking out loans is appropriate or whether the type of credit is appropriate let alone the credit's final utilisation and exposure thereof will unilaterally be shifted to the credit institution.

2. Need for greater specification of the disclosure obligation of the consumer

The new Commission Proposal theoretically assumes a mutual pre-contractual information obligation of all parties to the agreement. Yet, contrary to the second report of the Committee for legal affairs and the internal market,¹⁵ which specified these information requirements for both sides, in the Commission Proposal there is only a unilateral list of the specific obligations, i.e. obligations which the credit institution has to meet *vis à vis* the consumer.

Contrary to this, the information obligation of the consumer *vis à vis* the credit institution is not sufficiently specified. It is addressed only indirectly under the creditor's obligation to carry out a creditworthiness assessment which must be based on the "information given by the borrower". Yet, there are no provisions as to which information must be given by the consumer and whether he is subject to a disclosure obligation when it comes to relevant information. There is not even an adoption into the new version of the obligation for the consumer pursuant to Art. 6 paragraph 1 of the Commission Proposal dated 2002 to answer to potential questions by the credit institution "accurately and in full". Yet, without this obligation it remains doubtful whether the creditor will be able to rely on the information provided by the client.

In order to prevent that the information obligation of the consumer will eventually become inconsequential, there is first and foremost an urgent need for greater specification.

Information requirements of the consumer which would need to be explicitly specified should cover:

- his exact address, his date of birth, nationality, marital status and the matrimonial property regime as well as,
- detailed information on type and length of profession including the name of the employer and the industry,
- a detailed list of his assets which would notably have to include the type, level and legal grounds for his income (e.g. income from self-employed or gainful employment, rental income, income from capital assets as well as other regular income such as child benefits etc.),

¹⁵ A.a.O., Fn. 2.

- information on any adults living in his household, persons entitled to maintenance as well as children entitled to maintenance,
- a detailed list of his liabilities which must notably include the type, level and legal grounds for these liabilities (e.g. car costs, insurance policies, maintenance payments, costs of living, rental payments or payments towards the upkeep of personal real property, social insurance contributions, savings schemes, amounts payable due to other loan liabilities and leasing instalments).

Furthermore, there needs to be a reflection of the fact that credit institutions will regularly have no opportunity to cover each and any contingency which may impair the capacity of the consumer to meet his contractual obligations. In order to ensure that the lending decision can be taken under due consideration of the actual income and outgoings of the consumer, the consumer must therefore explicitly become subject to an independent cooperation or, moreover, disclosure obligation notably in relation to potential expenses which may not be covered by the questions of the credit institution and which only the consumer can know.

Since this information may otherwise become meaningless for the creditor, last but not least, the consumer's responsibility to answer "accurately and in full" to the questions put by the creditor, should be reintroduced from the initial Proposal.

3. List of information requirements in Art. 5 paragraph 2 a) to l)

The obligation for credit institutions to disclose those costs which occur in the context of concluding a credit agreement needs to be limited to those costs which are owed by the borrower to the creditor when there is correct performance of the agreement. The Commission's view expressed under Article 5 paragraph 2 h) of the revised Proposal that the credit institution should also name third party costs to the borrower is unrealistic because the credit institution will regularly not be aware of such costs (cf. above IV.). Hence, – unless the envisaged requirement of stating the costs for notaries, fiscal authorities, Land Registries or the mentioned ancillary services in the context of the credit agreement were to be dropped – said requirement would have to be amended to the effect that disclosure of these costs shall only be mandatory if and when they would be *de facto* available or, moreover, if they are not known, that they would only have to be disclosed in very basic terms. A potential obligation to extrapolate the costs "in advance" as has been pointed out notably with regard to ancillary services, would lead to extra costs for the creditor which would have to be rolled over to the client (cf. IV.).

The inconsistencies which would result especially in this regard between the definition of the total amount of the credit and the information obligation pursuant to item h) have already been pointed out earlier (cf. I.2).

4. Possibility for compliance with "Pre-contractual information by handing out a draft agreement"

Pursuant to the last sentence of paragraph 2 there shall be an explicit provision stipulating that a credit institution shall be allowed to convey the mandatory "information" in a way where the borrower shall be given a complete draft of the envisaged agreement for information purposes into which the required information have been entered. We welcome this fact. Already "prior to the agreement" this approach notably allows the consumer to not only familiarise himself with the abstract information pursuant to Art. 6, paragraph 2 (4) a) to i) CCD Proposal but to familiarise himself also with the more specific details of the envisaged agreement.

5. Establishing the most appropriate type and total amount of credit – need to delete Art. 5 Paragraph 4 CCD Proposal

The Commission seeks to maintain its first Proposal were it planned to impose upon the credit institution the obligation that the latter "shall seek to establish, among the credit agreements they usually offer or arrange, the most appropriate type and total amount of credit taking into account the financial situation of the consumer, the advantages and disadvantages associated with the product proposed and the purpose of the credit" Art. 5 paragraph 4, CCD Proposal).

Such a regime would unilaterally shift the responsibility for taking out a loan to the credit institution.

It is indeed understandable and correct that, when signing the credit agreement, the consumer must receive correct information on the product. Yet, the responsibility for signing a credit agreement and for the content of such credit agreement shall be incumbent upon the consumer. The role of the credit institution may only consist in providing the consumer with enough information so he can take an informed and considered choice. It can and must not be the role of the European legislator to patronise the consumer during lending transactions and to unilaterally shift the responsibility to credit institutions.

Credit institution can not assume responsibility of deciding for and on behalf of the consumer whether taking out a loan is appropriate or not; already due to the information asymmetry, any

such attempts would be doomed to failure. Credit institutions can not decide for the consumer whether a type of credit is appropriate nor can they assume the risk concerning the credit's purpose. This is due to the fact that *de facto* credit institutions would not be in a position to conclusively assess "whether" a loan is in effect really "appropriate" in the consumer's specific personal situation. It is also due to the fact that the credit institution will not know which type of credit will be potentially most appropriate for the customer's interests. The rulings of Germany's Federal Court of Justice have reflected this matter of fact for many decades now¹⁶. Any such plans would completely exceed the realistic capabilities of credit institutions during lending transactions. A credit institution will regularly not be capable of assessing whether or not a transaction which is planned by the consumer and which shall be financed by the credit institution (i.e. for instance a purchase agreement) is "appropriate" or not. After all, the credit institution will in most instances have no influence on the contractual relations between the consumer who is taking out the loan and his other creditors. If and when such a far-reaching responsibility which also involves an assessment of the "appropriateness" of the foreign currency transaction was imposed upon a credit institution, then this would eventually lead to an – unlimited – liability of the credit institution for the economic success of the financed (foreign currency) transaction.

Hence, it is absolutely essential to clarify under Art. 5 CCD Proposal that a credit institution shall not be obligated to inform the borrower of the advantages and disadvantages associated with the transaction that needs to be financed.

Furthermore, it should always be left to the client's own discretion how much information he wishes to receive. It would make little sense to inform the client of the various credit types if he already has a clear idea with a view to the product he would like to purchase.

Notwithstanding the foregoing, one further reason for objection to an extension of the lenders' obligations which is envisaged by the Commission Proposal also meets with fundamental concerns under liability aspects. This is due to the fact that such a comprehensive advice obligation as envisaged by the Commission Proposal would lend itself to an excuse for clients who can not pay back the credit. Potentially, clients could initially challenge the creditor's title to repayment or could file for a law suit and claim damages on the grounds that they had allegedly not received correct advice with regard to the total amount of credit or the type of credit. Especially those clients where repayment was not jeopardised as a result of an extraordinary, unforeseen event but who simply did not exercise the necessary financial restraint in order to subsequently meet their obligations under the credit agreement when and where due could easily

¹⁶ Suffice it to mention BGH WM 1991, pp. 179 ff., BGH WM 1992, pp. 977 ff., BGH WM 2000, pp. 1685 ff. respectively w. f. m.

argue that the credit level had not been fixed correctly. Under German law, they would then basically have an opportunity to file for damages pursuant to section 280 paragraph 1, 311 paragraph 2 German Civil Code of Justice on the grounds of a breach of information or advice obligations. In order to limit the risk of an inflationary proliferation of legal prosecution, the consequence would be that the extension of consumer loans would have to be handled in a far more restrictive manner. This would especially mean that a safety margin would have to be added to the credit amount regardless of the client's creditworthiness.

Hence, there is an urgent need to entirely delete the provision proposed under Art. 5 paragraph 4.

VI. Art. 7 – "Access to data bases"

We welcome the fact that the Commission now plans to renounce the need for introduction of new data base infrastructure and a mandatory database query. Instead, it merely plans to secure a level playing field so that all lenders have cross-border access to databases.

Already under the existing regulatory regime, the "principle of mutuality" allows credit information systems located in the individual countries – notably via cross-border cooperation agreements – to carry out data base queries in other European countries. Hence, the establishment of central databases would have been completely redundant under the existing regulatory regime. Furthermore, the question who would have had to build and finance the envisaged database infrastructure was left completely open under the initial proposal. In the final analysis, the costs incurred by this exercise would have had to be paid by the consumer.

VII. Art. 10 – "Information which shall be included in the credit or surety agreement"

1. Credit institutions will not be capable of disclosing all costs

The Commission Proposal stipulates that - in the credit agreement - the credit institution must state the "costs indicating their purpose and amounts, which are not included in the calculation of the annual percentage rate of charge" (Art. 10 paragraph 2 g); this provision fails to predicate this obligation on an awareness of such costs and hence creates an unlimited liability. The provision also stipulates that the disclosure obligation would specifically include the charges of "defaulting".

Credit institutions, however, will generally not be capable of stating potential costs of defaulting: If and when the borrower fails to meet the obligations under the agreement, then he will become liable to the credit institution for damages. Yet, the exact type, scope and level of the damage can

only be ascertained once there is an instance of default. Stating such costs *a priori*, i.e. when the agreement is being signed, will be virtually impossible. Only estimates of such costs can be given when the credit agreement is being signed. The same reservation applies in relation to the Commission Proposal concerning the disclosure obligation in the context of surety agreements (cf. Art. 10 paragraph 3 CCD Proposal).

The provisions under Art. 10 paragraph 2 e) and paragraph 3 CCD Proposal should hence be confined to a disclosure obligation for those cost elements which the consumer will have to pay if and when there is correct loan performance. Whenever the exact level of costs is unknown, the mandatory requirement should only extend to an obligation to the effect that these costs shall only have to be indicated in very broad terms.

2. Possibility to conclude agreements in an electronic form

Under German law, the conclusion of a consumer credit agreement in an electronic form shall not be legally effective (cf. section 492 paragraph 1 (2) of the German Civil Code). Based on Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures, Denmark, for instance, has already harmonised its national law and made it possible to conclude consumer credit agreements in an electronic form, i.e. by using digital signatures. To date, the German legislator has refrained from such an amendment. This is notably due to the fact that the existing CCD explicitly requests that "credit agreements shall be made in writing" (Art. 4, paragraph 1). This is further compounded by a conspicuous absence of a clarification when the European Signature Directive was incorporated into the European Consumer Credit Directive: during this exercise, no explicit provision has been included that would request that the rule that "credit agreements shall be made in writing" contained in Art. 4 paragraph 1 of the Consumer Credit Directive may also be complied with by signing the credit agreement with a digital signature as contemplated by the signature Directive. By default, the German legislator has construed this as meaning that such digital signatures shall not be valid for the purposes of signing credit agreements. In order to prevent that the scope of the signature Directive will continue to be interpreted differently across individual European Member States, the forthcoming amendment of the CCD should include an explicit clarification that compliance with the Directive's provision that "credit agreements shall be made in writing" shall also be achieved by signing the credit agreement by means of a digital signature as contemplated by the signature Directive. This clarification could be achieved by adding it is not only possible to prepare the agreement by means of a durable medium but that it is also legitimate to conclude such an agreement in a corresponding manner, i.e. that the conclusion of credit agreements in an electronic shall meet the formal requirements under the CCD (cf. I.3.).

VII. Art. 11 – "Right of withdrawal"

We essentially welcome the idea of introducing a right of withdrawal. This approach seeks to bring the conditions under which a consumer may potentially withdraw from an agreement more into line with the provisions contained under other Directives.

We also welcome the fact that the Commission Proposal creates (*inter alia*) an exemption from the right of withdrawal for such credit agreements which "are secured either by a mortgage on immovable property or by a surety commonly used in a Member State for this purpose" (Art. 11 paragraph 4 of the CCD Proposal). This provision takes account of the peculiarities of mortgage lendings, i.e. their refinancing at matching maturities. Hence, it is to be explicitly welcomed and necessary. This provision should be adopted into the final text of the Directive without any further amendments. It is our understanding that the Commission Proposal also seeks to provide a conditional waiver for credit agreements that are concluded with an official. Again, this is an amendment which we strongly endorse.

IX. Art. 14 – "Borrowing rate"

1. Possibility for credit institutions to adjust the borrowing rate of the credit based on changed refinancing possibilities in the money and capital market

The premise of the provision under Art. 14 CCD Proposal is that the "borrowing rate" – i.e. the nominal interest rate – as an interest rate shall "exclude all other costs". This underlying premise is correct. Hence, in this respect we can agree to the provision. Yet, this provision falls short of taking account of the refinancing mechanisms of credit institutions on which the interest adjustment is based.

Thus, the Commission Proposal would need to be amended in order to reflect the following facts:

Credit institutions do not lend their own money. They lend funds which they themselves borrow from money and capital markets. Hence, when agreeing a floating interest rate with the borrower, a credit institution must accordingly have an opportunity to adjust this interest rate to the various refinancing opportunities at the money and capital market. The mechanism of adjusting floating interest rates on the basis of changed refinancing opportunities in the money and capital market is

based on general refinancing principles¹⁷ which are recognised even beyond national borders. Therefore, in terms of the legal structure of interest rate agreements, a credit institution is essentially faced with three choices:

- the credit institution can agree a fixed interest rate with the borrower (fixed rate agreement), namely also in the form of several consecutive fixed interest rate intervals (period financing),
- the borrower and the credit institution may sign a floating rate agreement with the consequence that the interest rate agreed with the borrower is directly linked to changes in the benchmark parameter or
- the credit institution and the borrower may agree that the credit institution adjusts the interest rate based on the changed refinancing possibilities in the money and capital market by way of – what in Germany is called - a unilateral right to determine performance.

The Commission Proposal contains plans to deny credit institutions the right to draw upon the foregoing third option (Art. 14 paragraph 3 CCD Proposal). Such an amendment would be unjustified and we therefore propose an amendment of the Commission Proposal (Art. 14 paragraph 3 CCD Proposal) so that the option to unilaterally adjust the interest rate on the basis of a benchmark parameter by way of a unilateral right to determine performance will be maintained. By way of addition, it could be pointed out that a credit institution which has the contractual right to unilaterally adjust the interest rate to changed refinancing possibilities in the money and capital market must carry out this adjustment based on an interest rate of the European Central Bank and in an appropriate manner.

2. Changes in the wake of the new Basel Capital Adequacy Accord ("Basel II")

Since 1997, delegates of the G10 Central Banks and of the authorities for banking supervision have been working on a fundamental review of the Basel Capital Adequacy Accord. Here, the goal is essentially that when granting loans, credit institutions shall have to take greater account especially of the loss given default of the surety and of the client specific default exposure (probability of default), notably in but not limited to those cases where the latter change during a credit's lifespan. The assessment of the client specific probability of default shall take place on the basis of officially recognised prudential risk rating approaches. The regulatory scope of Basel II

¹⁷ For the German jurisdiction by way of example we would like to refer to microeconomic and legal presentations by Rolfes, "Kalkulatorische Aspekte der laufenden Anpassung variabler Kreditkonditionen", WM 2001, pp. 762 ff., as well as Habersack, "Zinsänderungsklauseln im Lichte des AGBG und des VerbrKrG", WM 2001, pp. 753 ff.

shall cover all banks from European Member States (i.e. Basel II shall apply to all banks regardless of what their Home/Host Member State is, as long as they are based in a European Member State). Furthermore, the Basel II regime's regulatory scope shall extend to both corporate and retail clients alike.

The Commission Proposal fails to reflect the new Basel II provisions. Given their wideranging scope (cf. above), there is a compelling need to clarify under Art. 14 CCD Proposal that a credit institution shall be entitled to adjust a fixed or variable interest rate in the contractual relations to the borrower if a review based on the criteria of an officially recognised prudential risk rating approach under the Basel II regime reveals that the client's probability of default or the surety's loss given default (LGD) have changed.

X. Art. 16 – "Right of early repayment"

The Commission proposal seeks to grant clients with a right of early repayment of their liabilities under the credit agreement (Article 16 (1) CCD Proposal). At the request of the European Parliament, the Commission even expanded its initial proposal. Due to the Proposal clients may even exercise such right of repayment "at any time".

This planned provision further compounds our concerns over Art. 3 paragraph 2 a) CCD Proposal. As has been highlighted earlier, we strongly advocate that loans secured by mortgage on immovable property shall be entirely excluded from the scope of the Directive. Should the Commission, despite our reservations, refrain from exempting loans secured by mortgage on immovable property from the scope of the Directive, this would have very serious consequences for fixed interest loans secured by mortgage on immovable property. In other words: such loans could no longer be offered under the current terms. Yet, in Germany fixed interest loans secured by mortgage on immovable property are very popular since they are very favourable for the consumer. Nevertheless, the Commission proposals would destroy the possibility to legally agree an effective waiver of the right to termination for fixed interest loans. Since 01 January 1964, this has been legally possible in Germany (cf. section 247 paragraph 2/2 German Civil Code a. F., section 609 a paragraph 1 German Civil Code a. F., section 489 paragraph 1 German Civil) and forms for instance the legal basis so that credit institutions which have to create statutory cover funds pursuant to the ÖPG or, moreover, Germany's Commercial Code may set-up a statutory cover stock for the issuing of debentures. The respective academic literature emphasizes the context between maturity matching of the lending business, deposit-taking

operations and the waiver of the right to termination of the loan agreement¹⁸. Unless the Commission Proposal were to be amended, these institutions would no longer have the opportunity of refinancing the underlying loans by issuing debentures. In effect, this would mean that they would have to move on to more costly refinancing options. The resulting additional costs would have to be rolled over.

Hence, the coming into effect of this provision would not only constrain the product variety and the consumer's economic freedom of choice. What is more, it would also deprive him of efficient safeguards against interest rate fluctuations. With regard to fixed interest rate loans which are secured by mortgage on immovable property we therefore propose that early termination shall only be possible in exceptional cases under very stringent preconditions (for the German law cf. section 490 paragraph 2 German Civil Code).

Furthermore, the Proposal under Article 16 paragraph 2 restricts the right of credit institutions to request compensation for early repayment.

Under German law it is an accepted fact that the early repayment indemnity serves the purposes of repaying the damage to the creditor which results from an early repayment of the loan currency and to put him in a position "in which he would also find himself if and when the loan agreement had been duly performed" (section 249 German Civil Code)¹⁹. Corresponding provisions will similarly apply in other Member States. Hence, we welcome the fact that the Commission now clarifies this more precisely in its wording ("indemnity").

Notwithstanding the foregoing, the qualification of this indemnity is problematic. On the one hand, the creditor would, on principle, be able to ask for a "fair and objective indemnity". Yet, in the recitals it then says that this "indemnity must consist in a fair indemnity"; yet, it furthermore stipulates that it would only be "fair if it takes into account the interests of *both* contractual parties". Yet, a party seeking early repayment will never be interested in simultaneous payment of an indemnity. Consideration of this interest would hence regularly lead to a reduction of the indemnity despite the borrower's breach of contract.

Furthermore, it is not immediately clear to us why a derogation should be made from the creditor's right to call for such a kind of indemnity for those credit agreements where the period used to fix the borrowing rate is less than one year. Even when this period is less than one year, any breach of contract on the part of the client may still incur a damage for banks. It is not clear why such

¹⁸ Cf. Bellinger/Kerl, Hypothekbankgesetz, vor §§ 14 - 21 a marginal number 25 at the end.

¹⁹ Suffice it to mention BGH WM 1997, pp. 1747 ff., as well as the recital of the government bill on the amendment of the German law of obligations, BT-Drs. 14/6040, p. 254 f.

damage would not have to be replaced. Besides, this would equally violate the principle that indemnities must take "into account the interests of *both* contractual parties".

XI. Art. 19 – "Linked transactions"

Art. 19 paragraph 1 CCD Proposal is identical with Art. 11 paragraph 1 under the current CCD.

This notwithstanding, Art. 19 paragraph 2 CCD Proposal stipulates legal consequences which exceed the legal consequences under the present CCD. This means that the initial Proposal remains largely unamended. This is even more surprising because, between its first Proposal for a CCD and its second one, the Commission had announced that it would abandon the concept of a joint and several liability in favour of the concept of the "linked transaction". Yet, these plans have not materialised under the present proposal, it basically provides for a continuation of the policy of the joint and several liability. The only difference with regard to its first Proposal is that the heading of Article 19 has been changed into "linked transactions". Here, the Commission seems to overlook that this involves entirely different liability approaches with different scopes.

What is more, Art. 11 paragraph 2 of the present CCD does not aim at such a broad liability regime as is now envisaged by Art. 19 paragraph 2 CCD Proposal. Under the existing CCD, the consumer may seek redress under certain preconditions that are explicitly listed under Art. 11. Yet, it is not immediately clear to us what this redress should be that is triggered when the circumstances listed under Art. 11 are met. In our preliminary understanding, such redress can only mean that the consumer may be entitled to refuse payment of outstanding instalments of loan repayment (cf. also section 359 German Civil Code). Art. 11 paragraph 1 of the current Directive 98/7/EC as well as from Art. 19 paragraph 1 of the Commission Proposal indicate that the motivation behind these provisions is protecting the consumer from disadvantages which may result from a breakdown of a process which – from a business point of view – is one single, integrated process; in other words he shall not be in a less advantageous position than during regular "instalment buying" agreements. What is not intended, however, is a privileged treatment of this buyer *vis à vis* a buyer who only signs a contract with one single contractual partner. Yet, such a kind of privileged treatment would be the case if the consumer was given an independent title to damages *vis-à-vis* the creditor should issues occur in the foreign currency relations; yet, this is precisely the approach that is envisaged under Art. 19 paragraph 2 CCD Proposal. This legal consequence would lead to a doubling of the liability assets which is unjustified from an objective point of view. Therefore, we strongly object to the liability regime envisaged under Art. 19 paragraph 2 CCD Proposal.

Contrary to the present CCD, the Commission's Proposal (i.e. its provision under Art. 19 paragraph 2) no longer specifies the criteria for cases that would be treated under a "joint and several" responsibility. In terms of its practical application, this poses a problem. In its present version, the provision under Art. 19 paragraph 2 well exceeds the present legal regime (cf. for German law the provision under section 359 German Civil Code) which leads to completely inappropriate results from a business point of view.

We therefore propose keeping the present list contained under Art. 11 paragraph 2 a) to e) of the present CCD in the amendment under the Art. 19 paragraph 2.

XII. Art. 21 – "Credit agreement in the form of an advance on a current account or on a debit account"

Art. 21 CCD Proposal seeks to continue the existing provision under Article 6 CCD. The Directive's approach to inform the account holder concerning authorised overdrafts on current accounts and tacit overdrafts "in regular intervals by means of a statement of accounts" on the "status of his liabilities" has proven successful and should therefore be maintained.

With regard to overdrafts agreed or tolerated on current accounts and the waiver contained under the present Directive by Art. 2 paragraph 1 e) it is therefore necessary that the provisions under the current Directive 98/7/EC be maintained in their current form. For a more detailed discussion cf. the presentations under Art. 3 (cf. II.2.).

XIII. Art. 22 – "Open-end credit agreement"

When compared to its first Proposal, the Commission's second Proposal for a CCD incorporates the unamended provision under Art. 22. Pursuant to this provision, both parties can only terminate open-ended credit agreements subject to a three month notice period. We have strong reservations over this provision which would have serious repercussions for the banking industry. We therefore propose an amendment thereof.

Under the prudential supervision rules which apply to all European banks, credit institutions shall back any risk assets (e.g. loans) with 8 % of liable capital or, to put it differently: An institution's scope for further lending equals the factor 12.5 of the liable capital. Germany's competent authority for banking supervision (BaFin, formerly known as BAKred) has issued a large number of provisions on the implementation of capital adequacy requirements by banks. Under Germany's current supervisory regime, banks shall have the right to exempt from principle I recognition (cf.

above) loan commitments to private and corporate clients which have been made "until further notice" and which serve the purpose of providing liquidity (so-called loan facilities valid until further notice) provided that certain preconditions are met. This includes notably the credit facilities and overdrafts granted on current accounts. However, the German supervisor also stipulates as one major precondition for this privileged treatment of loan facilities granted until further notice that these loans "are eligible for termination without any further notice and that this eligibility shall be laid down in the terms of trade of banks and savings banks." Yet, if and when loan undertakings are made in a form that no longer allows the institution to include an option for cancellation without notice, pursuant to section 8 No. 2 d) of "principle I", such loan commitments would have to be treated as off-balance sheet transactions. Treating them as off-balance sheet transactions would require a 50% capital backing with liable capital.

In order to take account of this existing prudential supervision framework, inter alia the standard terms of trade of banks, savings banks and of Central Savings Banks under item 19 paragraph 2 or, moreover, item 26 paragraph 2, contain provisions pursuant to which e.g. loans and loan commitments for which neither a term to maturity nor a digressing termination arrangement has been agreed may be cancelled by the corresponding credit institution at any point in time without having to comply with any further notice period. In order to prevent that the borrower will be unduly disadvantaged through the direct termination possibility, the terms of trade stipulate that when exercising the right of termination, the legitimate concerns of the client need to be taken into account. Comparable provisions are also contained in the terms of trade of other banking sectors.

The efficiency of the quoted provisions has been repeatedly confirmed by the German jurisdiction²⁰ and is also in line with the amendment of the law on obligations which came into effect on 1 January 2002²¹.

Should the provisions which are now proposed by the European Commission under Art. 22 of the CCD Proposal come into force, this would mean that in future credit institutions would have to back the corresponding loans with liable capital. This, in turn, would mean that for credit institutions business opportunities would suffer a substantial limitation. Furthermore, the provision would generally lead to a cost increase for loans. This is due to the fact that banks would have to roll over to the client the additional costs for capital backing. In Germany this would, for instance, affect all overdrafts made available on current accounts.

²⁰ Cf. The most recent example of the OLG Köln, WM 1999, pp. 1004 ff. on item 19 paragraph 2 AGB-banks.

²¹ Cf. recital of the government bill, BT-Drs 14/6040, p. 254 (recital on section 490 German Civil Code of Justice).

In order to prevent the potential consequences outlined above, there is hence a compelling need to shape the provision under Art. 22 CCD Proposal in a way which allows credit institutions to maintain the possibility to terminate loans and loan undertakings for which neither a maturity nor a deviating termination regime has been agreed without any further notice. Simultaneously, the credit institutions could be put under the obligation that when the credit relationship is wound up, they will be duty-bound to take adequate account of clients' legitimate concerns and that they will especially have to offer the latter an adequate deadline for loan repayment.

XIV. Art. 23 – "Performance of the surety agreement"

Already in the context of Art. 3 (cf. II.5) reference has been made to the fact that there are good reasons which speak in favour of including surety agreements under the scope of the Directive.

Concerning Art. 23 CCD Proposal we should like to add that the provisions envisaged there under would devalue sureties to an extent where this would significantly burden the extension of consumer credits.

Relating both to personal sureties and real sureties, the forthcoming provision is especially problematic. In practice it will hardly be feasible. The mandatory time restriction of the surety agreement envisaged under Article 23, paragraph 1 CCD Proposal would in effect mean that after expiry of three years, sureties would be quasi "knocked out of the creditor's hands". What is more, the provision stipulates that an extension of the surety agreement only become possible after expiry of said period of time. Such a provision would *de facto* mean that consumers could no longer guarantee open-end credits.

An adequate level of credit collateralisation is and will remain mandatory under prudential supervision regimes. Hence, also for the future, there is a compelling need to ensure that credit institutions will be allowed to sign certain agreements that facilitate matching of maturities between the loan agreement and the surety agreement. This is why Art. 23 paragraph 1 CCD Proposal should not be incorporated into the final wording of the Directive.

Furthermore, the three month period of "insolvency" envisaged under paragraph 2 of the provision is not fit for practical purposes. This is due to the fact that especially in cases where there are outstanding balances of the total amount of credit owed by the consumer, there is frequently the need for fast action notably also in order to prevent that the guarantor will use this time for withdrawing from his obligations. This problem is further compounded by the addition which has been made by the Commission i.e. that the guarantor must be immediately alerted if the

consumer is defaulting. Hence, this provision should be deleted completely and without any replacement.

XV. Art. 24 – "Default notice and enforceability"

The aim of Art. 24 paragraph 1 b) CCD Proposal is to prevent that the consumer or the guarantor will be required to immediately repay the total amount of the credit unless the creditor has previously unsuccessfully issued a reminder addressed to the consumer or to the guarantor. Notably in cases where there is a default of payments where it is obvious that the financial situation of the borrower has deteriorated to an extent where the loan repayment is at stake, this provision does not take adequate account of the interests of the creditor. Under German law, the creditor is given the right to termination for reasonable cause (Art. 490 paragraph 1 German Civil Code of Justice) in said cases.

XVI. Art. 25 – "Overrunning the total amount of credit and tacit overdrafts"

We welcome the fact that Article 25 CCD Proposal of the Commission's second Proposal stipulates that the regulatory scope of the legal consequences associated with the overrunning of the total amount of credit shall no longer extend to each and any overrunning but that they shall rather only apply when there is a "significant" overrunning.

Notwithstanding the foregoing, Art. 25 paragraph 1 CCD Proposal only stipulates that the creditor shall have to inform the consumer of this overrunning "in the event of a significant overrunning of the total amount of the credit which endures for a period longer than one month". In effect, this would mean that the creditor would have to check after each transaction whether there is an overrunning or not. It would also mean that the one-month period could potentially have begun or ended after each transaction. However, in practice, such a control would hardly be possible or would only be possible if a huge effort was undertaken. In effect, this would considerably increase the costs for the account holder. It is doubtful whether under these conditions such credits could still be offered in their current unbureaucratic form.

The same applies with regard to Art. 25 paragraph 2 CCD Proposal. According to this Article, any significant overrunning of the total amount of credit "must be rectified within three months"²². This, too, would require a similar review as has been outlined above involving all the associated costs. The only other alternative would be to stop offering such credits altogether.

²² Interestingly enough, the German language version at this point uses the wording "within a period of more than three months", yet the English version of the text suggests an interpretation as has been quoted above.

XVII. Art. 31 – "Penalties"

Pursuant to Art. 31 CCD Proposal, Member States shall define sanctions for potential breaches of the provisions under the Directive. However already today, the Civil Code of Justice of the individual Member States features protection and penalty mechanisms for the client in cases where the credit institution is in breach of its obligations under the credit agreement or where there is a violation of statutory provisions. There is hence no need for further sanctions.

XVIII. Art. 34 – "Existing agreements"

Art. 34 of the CCD Proposal regulates the partial applicability of the Directive's provisions also to agreements which have been concluded in the past. This would create considerable costs.

We therefore welcome the fact that in the revised Commission Proposal, Art. 34 paragraph 2 has been deleted. With regard to existing agreements, even in the event of a simple payment default this Article would have triggered the obligation to present the creditor with an amortisation table. This would have created a disproportionate effort which would have led to considerably more red tape in lending transactions and a cost increase for credits.

Yet, what remains entirely divorced from the reality on the ground is the gist of Article 34, paragraph 3 of the CCD Proposal. This Article expresses the European Commission's notion that across the whole of Europe and within two years after the coming into effect of the Directive, credit institutions would have to replace all credit agreements and surety agreements by new agreements. For credit institutions, the costs for replacing several hundred million agreements across the whole of Europe within a period of two years would amount to several billion euros. Furthermore, such a kind of re-signature of each and any credit and surety agreement would inevitably mean that many credit agreements – last but not least due to the current difficult economic situation both in Europe and also worldwide – could no longer be continued in their present form but would have to be terminated; alternatively, their continuation could only be offered to the consumer at considerably higher costs.

Hence, the provision contained in Art. 34 CCD Proposal should be completely deleted.