

Will the Directive 2014/17/EU on mortgage credit protect consumers in the next economic and/or financial crisis?

Professor M. Elvira MENDEZ-PINEDO¹

Abstract

The Directive 2014/17/EU on mortgage credit agreements for real estate properties (Mortgage Credit Directive or MCD) reflects the classic tension in the European Union (EU) between the goal of attaining a European single mortgage credit market and the obligation to provide a high level of consumer protection. The classic approach of EU law to solve the tension is to find a balance between those aims through the interaction of public/private law. The article starts with a summary of the most important choices done by the legislator (ex-ante information duties and responsible credit) and essential consumer right. It follows with a critical assessment of the MCD. The methodology of this study is both descriptive and analytical, law is considered not only a normative system but also a set of policy instruments influenced by other disciplines (ie. economics). The findings lead both to optimism and to criticism. Although the European harmonization represents a further step ahead in the area of financial services and consumer protection, some critical questions are still forgotten or left aside. The most important question remains unanswered, whether the MCD will protect consumers when the next economic/financial crisis inevitably arrives. The implications are clear: more research and better policy are needed.

Keywords: mortgage credit agreements, EU law, EEA, consumer information, protection of consumer's rights, responsible lending.

JEL Classification: K12, K25, K33

1. Introduction

Mortgage credit is a financial service different from other kinds of banking and financial activities provided to individuals/consumers: consumer credit, investment services and/or payment services. The long expected "Mortgage Credit Directive" (MCD) or Directive 2014/17/EU² was adopted by the European Union in 2014 in the aftermath of serious financial, economic, euro and a sovereign-debt crisis affecting the periphery of Europe since 2008. This article focuses on the European Union and European Economic Area (EU/EEA) regulation on mortgage credit, that is to say residential immovable property credit agreements. We explore its legal framework and summarize its goals (access to finance and substantive protection) as well as comment some detailed rules in two selected areas: credit worthiness

¹ M. Elvira Mendez-Pinedo - professor of European Law (EU and EEA law) at the Law Faculty of the University of Iceland, mep@hi.is.

² Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010. (OJ L 60, 28.2.2014, pp. 34-85).

assessment (debtors' potential solvency) and actions following breach of mortgage credit agreement (reasonable tolerance towards debtors' payment difficulties).

The historical context of the directive is important since it explains some of the values behind European harmonization. Following the financial, banking, economic and euro-crisis from 2008, the attitude of the EU towards financial markets has evolved from broad supervision and self-regulation towards greater control of risks. In a parallel way, the new Directive inaugurates somehow a shift towards a new paradigm of "responsible lending" instead of just requiring the provision of due information. The two policy changes indicated above are important for two reasons: 1) they have a direct effect on consumer access to financial services and credit and 2) they determine the level and depth of consumer protection assured at European level. These issues will be covered more in depth later on.

Taking this context into account, this article intends to provide an overview of the directive and review in a critical way some of the most important issues. It is structured as follows. The second section gives a brief description of the paradigms in the field of European consumer law, the main key points of the directive and some other influential legislation in European banking and financial law. Section 3 discusses the incorporation of the Directive into the national legal systems, both in the EU and the EEA. Section 4 covers the classic tension between the goal of attaining a European single market while a high level of consumer protection must be guaranteed and the combined approach of EU institutions through public/private law. Section 5 explains the scope of the European legislation on mortgage credit. Section 6 focuses on the substance of the directive and its most novel provisions, duties imposed on financial institutions and consumer rights. Section 7 summarizes other complementary issues. Section 8 makes a critical assessment of the MCD and its interaction with national laws and considers some important issues to be dealt with *de lege ferenda* in the field of mortgage credit and consumer protection. Last but not least, Section 9 concludes with the most important question that maybe cannot be answered now in a straightforward way, the question whether this directive will protect consumers when the next economic/financial crisis inevitably arrive. Some final thoughts are expressed in the conclusions.

2. The new Directive 2014/17/EU on mortgage credit: key preliminary points

Before diving into more specific issues it is important to get an overview of this legislation. The Mortgage Credit Directive represents the first attempt of the European institutions to regulate this market. It applies to all loans made to consumers for the purpose of buying a property (usually home but not only), including loans that are guaranteed by a mortgage or by another comparable security, guarantee or lien. It belongs therefore to the area of European consumer law³.

³ For a more recent overview of the field see also Micklitz, Hans W., Reich, Norbert and Rott, Peter, *Understanding EU Consumer Law*, Intersentia, Antwerp/Oxford/Portland, 2009; Micklitz, Hans W, J

Consumer rights are first and most provided through a duty of information (classic approach). Consumers must be able to understand all available mortgage products, their different nature and the financial obligations that they will commit to. In this regard, lenders must provide consumers with standard information (European Standardised Information Sheet - ESIS) which allows them to shop around to identify the right product for them and to better understand the future contract with its pros and cons. The total cost of credit must be disclosed *ex-ante* when fix interest rates apply. When variable rates are preferred by parties, the cost must be recalculated and disclosed again at the time agreed (ie. once a year). The ESIS must include worst-case scenarios regarding the inevitable changes of variable interest rates and the depreciation of domestic currency in case of foreign currency loans so as to alert consumers of potential interest rate variations or other changes affecting the credit in a long-term contract. Total cost of credit includes all charges.

However, another new approach to protect consumers is the so-called “responsible lending” which is done by imposing new European wide standards to assess the credit worthiness of mortgage applicants so as to ensure that borrowers can meet their repayment obligations.

Together with better supply of objective information and this new European aim of prevention of over-indebtedness, consumers/borrowers are given a guaranteed period of reflection (a right of withdrawal) prior to being legally bound by the private credit agreement. Very importantly, consumers have now a general European right to repay their loans early, thus benefiting from a reduction in the total remaining cost of the mortgage. In such cases, EU/EEA countries may entitle lenders to fair compensation for any costs directly and exclusively linked to cases of early repayment.

The MCD establishes an EU passport regime for credit intermediaries (in principle once authorized in one EU country, a bank or financial institution or credit intermediary is allowed to provide services throughout the EU). Based on this principle, the MCD establishes furthermore some business conduct principles in the European market. In the first place lenders and credit intermediaries (i.e. persons or companies providing information and assistance to consumers looking for a mortgage loan) must act honestly and transparently in the consumer’s interests. In the second place, they must ensure that their staff have up-to-date knowledge on loan agreements and, once more, that customers are provided with all the necessary information before signing any binding contract.

Stuyck, Jules, Terryn, Evelyn (eds), Droshout, Dimitri (coordinator editor), *Cases, Materials and Text on Consumer Law*, Hart Publishing, Oxford, 2010, ch 6 on financial services, pp. 371-438; Weatherill, Stephen, “Consumer policy” (chapter 27) in Craig, Paul and De Búrca, Gráinne (eds), *The Evolution of EU Law*, 2nd ed., Oxford University Press, Oxford, 2011, pp. 837-868; and Ramsay, Ian, *Consumer Law and Policy*, 3rd ed, Hart Publishing, Oxford, 2012. For a recent study on mortgage credit and contract law see Domurath, Irina, *Consumer Vulnerability and Welfare in Mortgage Contracts*, Hart Publishing, Oxford, 2017.

It has to be noted that a corrigendum to the MCD was done in 2014⁴ and an amendment was introduced in 2016⁵ so it is useful to rely on the final consolidated text provided by the EU Official Journal. The directive requires Member States to set up national single contact points and to indicate all competent authorities⁶.

Apart from these substantive and formal key aspects, some other issues of European banking and financial law deserve to be commented since they affect the implementation and enforcement of the MCD in all EU/EEA countries. One implementing/delegated act has been already adopted by the European Commission regarding insurance/guarantees to be provided by financial institutions/credit intermediaries acting in the field⁷. As regards its concrete implementation in practice, the European Banking Agency has adopted three set of documents with guidelines for the application of the new MCD rules⁸:

- Guidelines on passport notifications for credit intermediaries
- Guidelines on arrears and foreclosure
- Guidelines on creditworthiness assessment

Furthermore, since the mortgage directive establishes specific rules for the calculation of the annual percentage rate of charge (APRC) of credit, a European formula is provided. A calculator based on the Directive's provisions is made available by the European Commission to help all actors involved (including regulators, consumers, creditors) calculate the APRC of a given amount of credit⁹.

In the area of mortgage credit it is also worth signaling the role of the European Banking Authority (EBA). The EBA contributes to the regulatory

⁴ Corrigendum to Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010. OJ L 246, 23.9.2015, p. 11-11.

⁵ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014. OJ L 171, 29.6.2016, p. 1-65.

⁶ The list is available online at the website of the European Commission, https://ec.europa.eu/info/law/mortgage-credit-directive-2014-17-eu/monitoring-and-enforcement_en (last accessed 21.11.2017).

⁷ The Directive establishes provisions for the follow up and the adoption of delegated acts. The Commission may adopt delegated acts to ensure a coherent harmonization and to take account of the evolution of the credit agreement markets. The power to adopt such acts was conferred on the Commission for an indeterminate period of time from 20 March 2014. The European Parliament or the Council may object to a delegated act within a period of three months from the date of notification (this period can be extended for three months). If the European Parliament or the Council make objections, the delegated act will not enter into force.

⁸ These guidelines can be found online at the website of the European Commission (last accessed 21.11.2017), https://ec.europa.eu/info/law/mortgage-credit-directive-2014-17-eu/implementation/guidance-implementation-and-interpretation-law_en.

⁹ The calculator and excel spread sheet model are available online at the website of the European Commission together with a guide and many different examples (last accessed 21.11.2017), https://ec.europa.eu/info/law/mortgage-credit-directive-2014-17-eu/implementation/guidance-implementation-and-interpretation-law_en.

work of the Commission by providing technical advice and drafting technical standards. It also publishes guidelines and recommendations to ensure the consistent and effective application of EU rules¹⁰. Furthermore, the Commission is assisted by the Government expert group on mortgage credit (GEMC). It is composed of representatives from all EU and some EFTA countries. Its main tasks are to assist the Commission in the definition and development of its mortgage credit policy, legislation and programmes¹¹.

As stated in the adopted legislation, the Commission shall undertake a review of this Directive by 21 March 2019.

3. Implementation in the national legal orders and incorporation into the European Economic Area (EEA)

The landscape of European Consumer Law is characterized by a combination of EU- based and national law rules¹² since the established practice based on the EU Treaties is to adopt EU consumer law through directives which harmonize selected aspects of national law and that co-exist with domestic public administrative and private consumer, contract and tort law.

The MCD has been in force since 20 March 2014 but it has not applied in practice to credit agreements existing before 21 March 2016, date in which all EU Member States were supposed to incorporate it into domestic legislation. National transposition measures have already been communicated to the European Commission and a list of all domestic legislative and regulatory acts related to the EU Directive is already available at the website of the institution¹³.

¹⁰ The EBA seeks to foster consumer protection in financial services across the EU by identifying and addressing some problems that consumers may experience, or are at risk of experiencing, when they deal with financial firms. According to the website of the institution, the role and tasks of the EBA include: collecting, analyzing and reporting on consumer trends in the EU; reviewing and coordinating financial literacy and education initiatives; developing training standards for the industry; contributing to the development of common disclosure rules; monitoring existing and new financial activities; issuing warnings if a financial activity poses a serious threat to the EBA's objectives as set out in the its funding Regulation; and temporarily prohibiting or restraining certain financial activities, provided certain conditions are met. Information on the EBA available online at www.eba.europa.eu (last accessed 21.11. 2017).

¹¹ The Government Expert Group on Mortgage Credit was established in early 2005. Representatives come from a range of bodies, including Ministries of Finance, Ministries of Justice, financial regulators, etc. See information on all expert groups working on financial regulation online at https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-reforms-and-their-progress/regulatory-process-financial-services/expert-groups-comitology-and-other-committees_en (last accessed 21.11.2017).

¹² Bolanca, Durda, *EU consumer law - The past and the future*, paper presented at the 2nd International Conference on Social Sciences held on 2-3 April 2016 in Istanbul, Turkey, document available online at http://ase-scoop.org/papers/IWLP-2016/5.Kekez_IWLP.pdf (last accessed 21.11.2017).

¹³ National transposition measures communicated by the EU Member States can be found online at the EU database eur-lex, <http://eur-lex.europa.eu/legal-content/EN/NIM/?uri=CELEX:32014L0017> (last accessed 21.11.2017).

Some EU countries have failed to do so. On 27 April 2017, the European Commission decided to refer Croatia, Cyprus, Portugal and Spain to the Court of Justice of the EU (ECJ) for not enacting the directive in their national legal systems. As the Commission has stated in this regard: *“the Member States' failure to implement the Directive means that consumers in these Member States cannot benefit from the protection guaranteed by the Directive when taking out their mortgage loans or when they experience difficulties repaying it. In addition, credit intermediaries cannot passport their commercial activities, depriving consumers in Croatia, Cyprus, Portugal and Spain of potentially better credit offers from lenders from outside these Member States.”*¹⁴

Since the MCD is a piece of legislation relating to the internal market, it has so called “EEA relevance”. The EEA Agreement signed originally in Oporto in 1992 between some EFTA countries and the EU Member States extends the territorial scope of the internal market to these countries. The EEA Agreement guarantees four fundamental freedoms (goods, services, people and capital) and some extra policies such as consumer protection (included in its Annex XIX). This means in practice that EU substantive has to be formally incorporated into the EEA legal order. Later on, with some inevitable delay, it will be adopted as domestic legislation by the Icelandic and Norwegian Parliaments (*Althingi* and *Storting* respectively) since Liechtenstein has a monistic system of dealing with international law. EFTA-EEA states do not participate in the formal legislative process but are obliged to adopt all EEA relevant legislation. At the moment the MCD is under scrutiny by the EFTA/EEA institutions¹⁵.

4. Creating a European single market while protecting consumers: a public/private law approach of minimum and maximum harmonization with two goals

As stated above, the Directive creates a common framework for credit agreements secured by a mortgage or otherwise relating to residential immovable property. The aim is to create an efficient single mortgage market at European scale by laying down conditions and harmonizing standards and practice to ensure a high

¹⁴ European Commission. Press release of 27 April 2017 on infringements of Directive 2014/17/EU, document available online at http://europa.eu/rapid/press-release_IP-17-1049_en.htm (last accessed 21.11.2017).

¹⁵ Agreement on the European Economic Area OJ L 1, 3.1.1994, pp. 3-522. Besides the four freedoms, it covers education, research, social affairs, consumer protection, company law and the environment, competition and state aid rules. It guarantees similar rights and obligations within the single market for citizens and economic operators and substantive law is regularly incorporated to the EEA legal order. In general, the EEA model offers a comparable consumer protection level with the reservation that regulations in the field of Judicial Cooperation in Civil Matters are not covered but the Lugano Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters is applicable. For a summary of the EEA see <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:em0024> (last accessed 21.11.2017).

level of professionalism on the part of lenders and credit intermediaries for the benefit of borrowers/debtors.

In order to create such a single internal market and provide a high European level of consumer protection, the Directive lays down normative prescriptions in relation to the provision of pre-contractual information through a standardized (ESIS) format and the calculation of the annual percentage rate of charge (APRC). These two areas mentioned by Article 2 of the Directive are constructed with the technique of "maximum harmonization" and Member States national law may not fail nor exceed the terms of the European legislation¹⁶. This is a well-known shift from minimum to maximum harmonization in European consumer contract law where the margin of discretion and flexibility of old directives has led to complete unified standards not always representing the highest possible protection¹⁷. By contrast, under Article 2 the rest of provisions of the MCD follow the technique of minimum harmonization. In all other areas Member States may maintain or introduce more stringent provisions of regulation/consumer protection provided they are consistent with their obligations under Union law.

As Mak has pointed out, the MCD is grounded in two domains¹⁸ since EU legislation on financial services and mortgage credit is situated within the areas of public and private law¹⁹. On the one hand the European legislator regulates contracts between providers of financial services/creditors and consumers/debtors. Most of these transactions are usually governed by national private contract law – with some occasional EU rules. Sometimes national tort law and/or rules of pre-contractual liability come into the scene as well. From the perspective of private contract law, the principle of party autonomy is paramount in all EU countries. Contract parties are therefore primarily responsible for their own decisions and the contract will be binding as law. On the other hand, the European legislator seeks to protect the weakest contracting parties in an asymmetric relationship because consumers lack of information or bargaining power who may sign a mortgage contract in a lifetime cannot be comparable to the expertise of banks/financial institutions that draft and sign these agreements every day. To this end, regulation through public law seeks to ensure that consumers have minimum rights to information ex-ante and/or that they

¹⁶ See also Article 14(2) and Annex II Part A with regard to standard pre-contractual information through a European Standardised Information Sheet (ESIS) and Article 17(1) to (5), (7) and (8) and Annex I with regard to a common, consistent Union standard for the calculation of the annual percentage rate of charge (APRC).

¹⁷ Rott, Peter, "Minimum harmonization for the completion of the internal market? The example of consumer sales law", *Common Market Law Review*, 2003, vol. 40 (5), pp. 1107-1135, in particular pp. 1115-1117.

¹⁸ Mak, Vanessa, "Financial Services and Consumer Protection", in Twigg-Flesner, Christian (ed.), *Research Handbook on EU Consumer and Contract Law*, Edward Elgar Publishing, Camberley and Cheltenham, UK, 2016, pp. 314-335 and specially pp. 315-316. An early draft of 2014 is available online at <https://ssrn.com/abstract=2497544> (last accessed 20.11.2017)

¹⁹ On the public-private nature of EU consumer law see Grundmann, Stefan, Kerber, Wolfgang and Weatherill, Stephen (eds), *Party Autonomy and the Role of Information in the Internal Market*, De Gruyter, Berlin, 2001.

are protected in alternative ways, such as through warnings²⁰. In this way, European law provides a fair level of minimum protection through the combination of private and public law.

Furthermore, the MCD aims for two complementary goals: 1) to facilitate access to credit to the general public at a European scale and 2) to achieve a minimum level of consumer protection through rules that will apply throughout the EU/EEA. It has a therefore double purpose. On one hand, it aims to ensure that all consumers who take out a mortgage to purchase a property are adequately informed and protected against the present and future risks of such a financial transaction (European consumer protection). On the other hand, the ultimate goal declared by the European institutions is to create a single market in mortgage credit in the EU-EEA area, a sector where markets are mostly nationally fragmented and consumer cannot compare offers since there are no competitors from other EU-EEA States.

5. Scope of application: mortgage credit and credit with similar guarantees

The MCD follows the path of the previous Consumer Credit Directive (CCD)²¹, still in force and applicable to all other credit not relating to residential property which intended to create a single market with cross-border contracts and a general framework of protection based on information duties.

Mortgage credit was excluded from the scope of the previous CCD by virtue of its article 2(2)(a) but has created a similar framework taking into account the specificities and nature of this contract that usually have a long term duration and rely heavily on regular variation of cost of credit as determined by variable interest rates. Article 3 MCD determines its scope of application. It applies to credit agreements secured either by a mortgage or by comparable security and/or right on residential immovable property; to credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building; and in business-to-consumer relationships. Not all credit agreements directly or indirectly affecting property are covered (ie. equity release, overdraft) and Member States may further more exclude certain category of agreements from the directive (ie. so called “buy-to-let) in certain circumstances.

²⁰ Mak, Vanessa (2016) op. cit. note 17 on p. 316.

²¹ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC. OJ L 133, 22.5.2008, p. 66-92. This previous directive harmonizes legislative, regulatory and administrative provisions of European Union countries on matters of credit granted to consumers borrowing to finance purchases of goods and services (holidays, goods, new car, etc.) It is not applicable to credit agreements guaranteed by a mortgage, signed in order to acquire land or property and/or a total amount is less than EUR 200 or greater than EUR 75,000 intended for the renovation of property which are regulated by Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property.

The co-existence of this directive with the CCD may pose problems in some countries that extended the scope of the consumer credit directive to mortgage credit such as Romania in the EU and Iceland in the EEA. In these countries the domestic legislators, administrative authorities and judicial organs must guarantee that the incorporation of the new MCD does not prejudice existing consumer rights (due respect of principles of legality and general non-retroactivity of lesser rights)²².

6. Dealing with mortgage credit: the main provisions of the Directive

While the MCD deals with many different issues there are several that stand out: the obligation to assess the financial capacity of the potential debtor (solvency control), the duties concerning the prior information and disclosure of the mortgage credit agreement to be signed and the cost of credit (protection through information paradigm), the reasonable tolerance or forbearance in case of breach of contract by debtors and the new paradigm of responsible credit.

6.1 Strict ex-ante solvency control of debtors and duty to deny credit

Banks and financial institutions operating in the mortgage credit market have the obligation to assess the creditworthiness of the consumer before concluding a credit agreement (Article 18). According to the MCD (recital 52), assessment shall take appropriate account of all factors relevant to verifying the financial solvency of the debtor, that is to say, the capacity of the consumer to meet his future obligations under the credit agreement²³. The creditor will only make the credit available to the consumer if the assessment is positive, that is to say, if it confirms that the obligations resulting from the credit agreement are likely to be met by the debtor in due time and manner under the contract. Where the credit assessment is negative, the creditor in principle should not offer a contract to the applicant. In this case, the bank or institution should inform the consumer without delay of the rejection and, where applicable, refer that the decision is based on automated processing of data informing of the particulars of the database/s consulted.

Contrary to the CCD that did not impose any duties on bank /credit institutions regarding advice, warning or denial of credit (but did not exclude it either in private laws of EU Member States); the MCD aims to construct a market where responsible credit (lending/borrowing) is the norm. By doing so, it is acknowledged

²² In this regard see for Romania, ECJ, case C-602/10 *SC Volksbank Romania* [2012] ECR I-0000 and for Iceland, EFTA Court, Case C-25/13 *Gunnar V. Engilbertsson and Íslandsbanki hf.* [2014] EFTA Court Reports, not yet reported (nyr.). Judgment of the EFTA Court of 28 August 2014 and Case C-27/13 *Sævar Jón Gunnarsson and Landsbankinn hf.* [2014] EFTA Court Reports nyr. Judgment of the EFTA Court of 24 November 2014.

²³ Article 20.1 establishes that the assessment of creditworthiness referred to shall be carried out on the basis of necessary, sufficient and proportionate information on the consumer's income and expenses as well as other financial and economic circumstances. The information shall be obtained by the creditor from relevant internal or external sources, including the consumer.

that access to credit may be less available than in the past. This choice is commented more in section 8.5. of this study.

6.2 Protection through information: ex-ante duties for creditors

The most important clauses of the MCD refer to the obligation to provide all substantive and formal pre-contractual information ex-ante, before the signature of the contract (Article 8). In this sense, the Directive establishes guidelines both on marketing and advertising and provides obligations on the creditors regarding the provision of general information as well as requirements regarding the credit agreement and total cost of credit (borrowing rate) (see specially Article 13 on general information and Article 14 on pre-contractual information). As stated above, the idea of a rational empowered consumer and the paradigm of protection through information are thus central to this directive²⁴.

The lender must thus provide the potential borrower with personalized information by means of the ESIS document (Annex II) and in such a way that it is possible to compare the credits available on the market, assess their different implications and make informed decisions (Article 14). The information must be provided to consumers free of charge and in a clear and comprehensible way.

Together with information duties, advice on credit agreements is regulated and some standards are specified by the MCD. The provision of advisory services should be based on a proper understanding of the consumer's situation as well as reasonable assumptions about potential risks to the consumer's circumstances during the lifetime of the credit agreement (Article 7). Furthermore, Member States are allowed to go further and provide for an obligation for creditors to warn a consumer when, considering the consumer's financial situation, a credit agreement may induce a specific risk in the future (Article 22.5).

6.3 Reasonable tolerance or forbearance in case of debtor's breach of contract

The most interesting clause of the MCD concerns the case of breach of contract (payment default) and subsequent foreclosures. While respecting the diversity of national civil procedural and contract laws, the Directive provides that Member States shall adopt measures to encourage creditors to exercise reasonable forbearance in case of payment difficulties affecting the debtor and before foreclosure proceedings are initiated (Article 28).

Furthermore, it establishes in the same article that where the creditor is permitted to impose charges on the consumer arising from the default, those charges

²⁴ For a recent update of the new paradigms adopted by European consumer law see O'Shea, Paul, Fairweather, Karen and Grantham, Ross, "Consumer Law: Paternalism, Fragmentation, and Centralised Enforcement" in O' Shea, Paul, Fairweather, Karen and Ross Grantham (eds.), *Credit, Consumers and the Law: After the Global Storm*, Routledge, Abington (UK), 2016, pp. 1-16.

should be no greater than is necessary to compensate the creditor for costs it has incurred as a result of the default.

6.4 Other important debtor/consumer rights

The MCD Directive provides time for reflection and/or right of withdrawal as mandatory clauses (Article 14). Consumers and potential debtors should have sufficient time of at least seven days to consider the longterm benefits and obligations of a mortgage agreement which spreads usually over a long period of time. Sufficient time should be given, either as a period of reflection before the credit agreement is concluded, or as a period of withdrawal after the conclusion of the credit agreement or as a combination of the two. Member States may opt for one or other taking into account their different legal traditions.

As for early repayment, the Directive establishes in Article 25 that consumers shall always have the right to repay the credit early, either fully or partially. In this case, Member States may provide that the creditor is entitled to fair and objective compensation, where justified, for possible costs directly linked to the early repayment. Member States may not allow creditors to impose a sanction on the consumer other than this sort of compensation.

7. Other complementary issues: financial education for consumers and supervision of credit institutions

While aiming to create a mortgage market and protecting consumer rights, the MCD recognizes the importance of education and financial literacy for consumers as well as due training of professionals operating in the sector. Responsible lending calls for a better understanding of both parties of their rights and obligations. In order to increase the ability of consumers to make informed decisions for themselves about borrowing, the Directive establishes that Member States should promote measures to support the education of consumers in relation to mortgage credit agreements in Article 6. At the same time, it says that creditors and credit intermediaries must require their staff to possess and to keep up-to-date an appropriate level of knowledge and competence in relation to the offer of credit agreements (Article 9).

The supervision of credit intermediaries is also important in this context. In this way, the Directive defines certain prudential and supervisory requirements, including for the establishment and supervision of credit intermediaries, appointed representatives and non-credit institutions. Before being able to carry out mortgage credit activities, all financial institutions credit intermediaries should be subject to an admission process by the competent authority of their home Member State (Article 35). They must also meet strict professional requirements at least in relation to their competence, good reputation and insurance or comparable guarantees

backing them up (an issue later dealt with in a delegated act²⁵). Information on all credit intermediaries operating in the market should be entered on a public register (Article 30).

8. Brief critical assessment of the EU mortgage credit Directive

This section does not aim to constitute a full and exhaustive study of the interaction between EU mortgage law and the different national legal orders in all 28/31 existing EU-EEA Member States but to point out to some important theoretical issues that have been discussed previously by doctrine and that are fully applicable to put this new European legislation to test.

8.1 More paternalism and greater convergence between consumer and financial/banking regulations

As it is the case in other jurisdictions such as Australia, USA and the UK, we find in the first place two themes that represent a sort of new fundamental approach in the European regulation towards consumer protection in the credit market²⁶: 1) a rise of a paternalistic perspective and 2) a move to try to address the divide between consumer law and finance/consumer regulation through convergence (ie. supervision of credit intermediaries, insurance/guarantees, guidelines to financial institutions, etc.).

8.2 A worrying lack of centralized enforcement authorities due to the nature of EU/EEA law

Recital 80 and Article 5 of the Directive refer to the competent authorities of all EU/EEA countries. This means that, contrary to those jurisdictions previously mentioned where newly established powerful national regulators have been provided with extensive administrative powers and fines to ensure compliance; the MCD does not centralize enforcement. This is because EU/EEA law establishes European rights that are, in principle, to be enforced at national level through domestic national remedies (principle of Member States' procedural autonomy).

In this regard, MCD is quite weak regarding enforcement since administrative rules for licenses, investigating powers and financial sanctions are left for the discretion of Member States with quite a big margin of discretion as to the standards and resources dedicated to the task. This is even more regrettable taking

²⁵ Commission Delegated Regulation (EU) No 1125/2014 of 19 September 2014 supplementing Directive 2014/17/EU of the European Parliament and of the Council with regard to regulatory technical standards on the minimum monetary amount of the professional indemnity insurance or comparable guarantee to be held by credit intermediaries. OJ L 305, 24.10.2014, p. 1-2.

²⁶ O'Shea, Paul, Fairweather, Karen and Grantham, Ross (2016), *op. cit.* note 24 on pp. 3-4.

into account that: 1) enforcement of rights in courts is expensive and slow²⁷ and 2) some countries such as the UK in the EU but also Iceland in the EEA created specialized public organs for advice and mediation of consumer debt claims (new Debtors Ombudsman in Iceland²⁸ from 2010 preceded by a Debt Advisory Center in 2008 following the crisis and/or the Financial Ombudsman Service in the UK since 2001²⁹).

8.3 Fragmentation of EU consumer law at national level still in place

EU *acquis* in the field of consumer law has been constructed over decades relying on a combination of selected European harmonized provisions along national domestic laws. However, this framework or matrix has been recently described as “wildly unsystematic” and lacking in coherence³⁰. The reasons are well-known: first of all, a history of different transposition of minimum harmonization Directives in too many different Member States; secondly, a diverse national interpretation of some European (*acquis*) legal concepts; and, thirdly, a mosaic of domestic individual measures, actions and programs not well coordinated and integrated with each other. The results of these factors have led to a situation where the law in most EU/EEA countries is now confused and complex, a fact bitterly criticized by the specialized doctrine³¹.

8.4 Paradigm of “information as protection” not enough, “responsible lending” added

The EU approach towards consumer protection has been traditionally grounded around the pillar of the information paradigm as interpreted by the Court of Justice of the EU on the basis of the EU Treaties, that is to say the assumption that consumers will be duly protected if and when they receive all information *ex-ante* on all important aspects of credit (rather than on substantive protection by regulation of all potential questions related to mortgage agreements and/or credit)³².

²⁷ *Ibid* on p.11.

²⁸ See for Iceland The Ombudsman for Debtors Act, No. 100/2010 and the websites <http://www.ums.is/english/> and http://ecdn.eu/wp-content/uploads/2016/07/ecdn_conf2011_iceland_Sigmarsdottir_EN1-1.pdf (last accessed 20.11.2017).

²⁹ The UK has a statutory dispute-resolution scheme set up under the provisions of Part XVI and Schedule 17 of the Financial Services and Markets Act 2000 (as amended) For information the website of this public body <http://www.financial-ombudsman.org.uk> (last accessed 20.11.2017)

³⁰ O’Shea, Paul, Fairweather, Karen and Grantham, Ross (2016), *op. cit.* note 24 on p. 10.

³¹ *Ibid* on p. 16.

³² On European consumer law see Nebbia, Paolisa and Askham, Tony, *EU consumer law*, Oxford University Press, Oxford, 2004 and Weatherill, Stephen, *EU consumer law and policy*, Edward Elgar Publishing, Camberley and Cheltenham, UK, 2005.

The particular image or conceptualization of the consumer as a market actor is behind all classic EU consumer law and is well-known to scholars³³. For a long time in the EU, the consumer has been considered and constructed as a *homo economicus*, a rational well informed agent of the market. In a parallel way, the approach taken and the values protected are the ones defined under a framework of “truth in lending” or disclosure of all essential elements of the credit contract³⁴.

Financial literacy as a cornerstone for European financial/credit consumer law is problematic since the choice of protecting by informing ex-ante does not guarantee adequately the protection of consumer’s economic and social rights³⁵. While consumers certainly benefit from greater transparency and information relating to contracts to be signed, this paradigm and subsequent policy of consumer protection (eventual empowerment) through information has been strongly criticized by academia³⁶. Empirical research has long ago proved that this approach fails to prevent market failures and duly protect consumers, even more so in the field of financial services.

For all the above reasons, Ramsay observes the need to revise the choice made and move towards a model “responsible lending”³⁷, something that has already started to happen in the aftermath of the financial crisis and the adopted MCD.

The paradigm of “information as protection” is not enough anymore, a duty of “responsible lending” has now been added. As Mak perfectly summarizes, we witness a period of transition: *„the law in this area is therefore in a state of flux: on the one hand, responsibilities of creditors and consumers are divided along traditional lines of party autonomy and empowerment through information; on the other hand, there is a push for greater protection of consumers, for example by imposing a duty of ‘responsible lending’ on credit providers. The Directive for now leans towards the first type of regime, empowerment through information, but may be complemented by more extensive in the private laws of the Member States.”*³⁸

³³ On normative choices made with regard to the image(s) of the consumer in European regulatory private law (ERPL) see Leczykiewicz, Dorota and Weatherill, Stephen, *The Images of the Consumer in EU Law: Legislation, Free Movement and Competition Law*, Hart Publishing, Oxford, 2016, previously published as an Oxford Legal Studies Research Paper No. 9/2016. available online at <https://ssrn.com/abstract=2743283> (last accessed 20.11.2017).

³⁴ O’Shea, Paul, Fairweather, Karen and Grantham, Ross (2016), *op. cit.* note 24 on p. 5.

³⁵ Howells, Geraint, “The Potential and Limits of Consumer Empowerment by Information”, *Journal of Law and Society*, vol. 32(3), pp. 349-370. The document is available online at <http://www.jstor.org/stable/3557237> (last accessed 20.11.2017).

³⁶ On the concept of ‘responsible lending’ in the consumer credit market, see also Mak, Vanessa and Braspenning, Jurgen, ‘Errare humanum est: Financial Literacy in European Consumer Credit Law’, *Journal of Consumer Policy*, 2012, vol. 35, pp. 307- 332 previously published as TISCO Working Paper Series on Banking, Finance and Services No. 01/2012, document available online at <https://ssrn.com/abstract=2016862> or <http://dx.doi.org/10.2139/ssrn.2016862> (last accessed 20.11.2017).

³⁷ Ramsay, Ian, “From Truth in Lending to Responsible Lending”, in Howells, Geraint, Janssen, Andre and Schulze, Robert, *Information Rights and Obligations*, Ashgate, Aldershot, 2005, pp. 48-57.

³⁸ Mak, Vanessa (2016), *op. cit.* note 20 on p. 320.

8.5 Is public law and more regulation through administrative law the solution?

At the same time, the idea of consumer protection through more regulation and public control might not be the answer to the needs of society. Most of the times regulators may not be in a better position than consumers to protect the diffuse needs and rights of consumers as a class. This is for several reasons: regulators may be also captured by stakeholders in the financial services industry, regulation is always one step behind the reality of the market and is always a response to the last [financial crisis] scandal, not the next³⁹.

Furthermore, a more incisive substantive normative regime of consumer protection can also have negative consequences. A stricter regulation of mortgage credit, for instance, might exclude consumers from access to mortgage credit and thus housing. If strong public measures are adopted, the result may well be that credit becomes unavailable to some groups of society (generally those at the lower income base of the pyramid). This consequence is also detrimental to most European societies where homeownership policies and economic/tax incentives provide security and welfare at a later stage of life. For some scholars, when such is the case, access to credit is to be preferred rather than increasing responsible lending duties⁴⁰.

8.6 Creation of single mortgage credit market is far from complete in practice

As stated earlier, access to mortgage credit has been traditionally out of the scope of the European consumer credit legislation. With the MCD the EU has decided to harmonize some of the most important circumstances of credit but not all questions come under the scope of the European legislation. This action will bring along some common standards and rules but will not create a single market for some important issues. In fact, individuals, households and small business/professionals may well continue to access credit under different circumstances/conditions and according to diverse standards.

8.6.1 Regulating all but core issue: silence on the price of mortgage credit

First of all, substantial differences persist regarding the cost of money in different parts of Europe. In this sense, it is worth noting the silence of the MCD on the cost of money or price of mortgage credit itself. This is obviously explained by the different stage and structure of economies and cycles in all Member States of the EU/EEA. In this respect, the situation is not going to change. Diversity of interest rates will still be the norm around Europe, and consumers will be offered different products specially in countries outside the euro area.

³⁹ O'Shea, Paul, Fairweather, Karen and Grantham, Ross (2016), *op. cit.* note 24 on p. 13.

⁴⁰ Mak, Vanessa (2016), *op. cit.* note 18 on p. 21.

8.6.2 *No interest-rate ceilings and no prohibition of usury (abusive extortionate cost of money) at European level*

Since the price of money is not regulated at all, some diversity will still exist concerning other issues of contract and tort law apart from due information duties or responsible lending principle, since domestic legislations and legal traditions (private law or civil codes) are still applicable and will be interpreted by national courts. One of the most obvious example is usury⁴¹, a practice only briefly mentioned one in recital 42 where it reads: “Member States should be free to maintain or introduce national law where no harmonised provisions exist, for instance information requirements on the level of usury rates at the pre-contractual stage”

8.6.3 *A single market for real estate properties is still very far away*

The financing of real estate investments for individuals and economic operators, one of the major businesses of most European banks and financial/credit institutions, is protected in cross-border cases by one of the four fundamental rules of the single market: the free movement of capital⁴². Unfortunately, even though the internal market for banks was completed in 1 January 1993, cross-border financing of real estate investments between countries is still an exception, which seems to be mainly due to the reluctance of the banks and differences among the national security instruments and procedural and substantive law applicable.

In the absence of a body of real state or property law⁴³, European contract law has already created far-reaching, though generally unintended, rules for real estate transactions, at least at national level (in particular the directives on doorstep sales, consumer credits and unfair terms⁴⁴).

8.7 Can national laws survive European harmonization?

The consequences of the new EU approach based on full/maximum harmonization of essential provisions and national private laws (mostly contract and tort laws) are still unclear. The main question: can national consumer laws still survive European harmonization? is very much debated between scholars and no

⁴¹ On the subject see Reifner, Udo and Schröder; Michael (eds), *Usury Laws: A legal and economic Evaluation of Interest Rate Restrictions in the European Union*, Books on Demand, UK, 2012.

⁴² The European Court of Justice of the European Union held in case *Trummer* that a national prohibition of registering mortgages in foreign currencies was unlawful. ECJ, case C-222/97, *Trummer and Mayer* [1999] ECR I- 1661.

⁴³ There is an ongoing research project at European level where the real property law of 15 different EU countries is explored. See information about the project online at <https://www.eui.eu/DepartmentsAndCentres/Law/ResearchAndTeaching/ResearchThemes/ProjectRealPropertyLaw#RPRC> (last accessed 20.11.2017).

⁴⁴ ECJ, cases C-481/99 *Heininger and other v. ... und Vereinsbank AG* [2001] ECR I-189 dealt with the consumer's right to withdraw from a real estate investment arrangement entered into on credit.

clear picture emerges⁴⁵. While lesser duties and lower standards are not possible anymore, it is not certain whether stricter national laws are to be set aside if rules are based on different legal grounds or fall outside the scope of this Directive. This point requires further research⁴⁶. In the alternative, clarification by the Court of Justice of the EU (ECJ) in a preliminary reference procedure would be very much welcome. This is so because, as stated above, maximum harmonization and lowering standards in some Member States has been heavily criticized by doctrine⁴⁷.

For the time being there are no substantive cases before the ECJ on the application of the MCD in different Member States. It is out of the scope of this study to comment all cases, previous to the MCD, where the ECJ has dealt with issues of mortgage credit in relation with unfair contract terms under Directive 13/93/EC and the required effectiveness of national procedural rules⁴⁸. However, a recent study conducted for the European Commission in the field of consumer protection and fundamental rights shows that, despite the fragmentation in the field and a lack of a specific instrument, the national courts and the ECJ have combined the use of some articles of the EU Charter of Fundamental Rights (EUCFR) (art. 38 on consumer protection and art. 47 on effective remedies⁴⁹) to enhance the protection of consumers and assess in a critical way the national provisions implementing EU directives either in terms of substantive and procedural law. The development of this strong connection with fundamental rights and intense judicial dialogue proves that judiciaries have some assumption or perception that consumers are vulnerable vis-à-vis the consequences of wider market failures emerging in particular in areas such as finance⁵⁰.

⁴⁵ See Vanessa Mak, "Review of the Consumer Acquis – Towards Maximum Harmonisation?", *European Review of Private Law*, 2009, vol. 17, p. 55-73; Cherednychenko, Olha, "Full Harmonisation of Retail Financial Services Contract Law in Europe: A Success or a Failure?", in Grundmann, Stefan and Atamer, Yes (eds), *Financial Services, Financial Crisis and General European Contract Law. Failure and Challenges of Contracting*, Kluwer Law International, Alphen aan den Rijn, 2011, pp. 221-258.

⁴⁶ Mak, Vanessa (2016), *op. cit.* note 18 on p. pp. 314-335.

⁴⁷ O'Shea, Paul, Fairweather, Karen and Grantham, Ross (2016), *op. cit.* note 24 on p. 10.

⁴⁸ Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. OJ L 95, 21.4.1993, p. 29–34. For a continuous update of case-law relating to European consumer law and mortgage credit see the blog online at <http://recent-ecl.blogspot.it/search/label/mortgage> (last accessed 20.11.2017).

⁴⁹ While article 38 EUCFR establishes consumer protection within the EU as a legal principle to be observed (it does not provide the basis for direct claims for positive measures); Article 47 EUCFR creates substantive right of citizens: it binds the Member States when acting within the scope of EU law, allowing full justiciability.

⁵⁰ ACTIONES Handbook on the Techniques of Judicial Interactions in the Application of the EU Charter. Active (EU) Charter Training through Interaction of National Experiences" (ACTIONES). Module 4 on Consumer Protection. Conference Version. European University Institute (Italy) 24.10.2017 document available online at <https://www.eui.eu/Projects/CentreForJudicialCooperation/Documents/Module-4.pdf> (last accessed 20.11.2017).

9. Will a European mortgage credit market and a MCD protect consumers in the next economic/financial crisis?

Obviously the goal of the directive is to protect consumers while favoring and constructing a European mortgage credit market. But other questions floating in the air will determine whether this can be achieved in practice. Have all countries and the EU learnt from past 2008 and 2010 financial, economic and euro/debt crisis? It is not automatic that countries and international organizations learn the lessons and adopt better policies to better protect consumers and debtors in the aftermath of those crisis. Recent research supported by OECD data has proved how differences in the severity of crises may yield opposite outcomes in elite perceptions toward financial stability which explain in turn the differences in policy and market outcomes at national level. Evidence shows that countries with a negative experience of financial crisis in the early 1990s were more likely to have smaller mortgage markets in comparison to other countries, and that this effect was stronger in countries with coordinative economic and policy institutions⁵¹.

The same is applicable to the EU. A weak supervision of the financial sector did not prevent the crisis nor losses affecting investors, credit takers or consumers. On the contrary, the crisis proved how EU/EEA credit legislation was ill-equipped to offer protection to consumers and to prevent them from credit choices leading to over-indebtedness and financial trouble⁵².

In this context, it is possible to argue that EU consumer and mortgage credit law offers unclear protection against over-indebtedness and financial hardship and mortgage payment difficulties in times of crisis. This is so for several reasons. First, it is difficult to reply to the questions of how and when credit is safe to start with. It is not possible to equate a policy of information ex-ante plus responsible credit with a high level of consumer protection since information and regulation do not protect against all risks of life and changes of personal circumstances.

Secondly, inevitable economic cycles and changes of interest rates will eventually occur during the lifetime of the contract. These are structural factors beyond the control of individuals and economic operators. The real question therefore is whether EU/EEA rules will be suited to operate and protect consumers taking into account not only the ordinary circumstances of life but the fact of capitalist economic cycles of expansion and contraction. This is more so because the creation and functioning of a global money/credit market balance is constructed

⁵¹ Bayram, Ismail Emre, *Once bitten, twice shy: financial crises, policy learning and mortgage markets in advanced capitalist economies*, European University Institute (EUI) PhD thesis, Department of Political and Social Sciences, Fiesole (Italy), 2014, abstract available online at <http://hdl.handle.net/1814/32127> (last accessed 20.11.2017).

⁵² For a comparative study of six countries in the aftermath of the financial crisis see Micklitz, Hans W. and Domurath, Irina (eds), *Consumer Debt and Social Exclusion in Europe*, Ashgate Publishing, Farnham, 2016.

upon both pillars of elasticity/discipline⁵³. Galbraith once referred to cycles of our Western capitalist economies as boom and bust⁵⁴ and this has been our most recent experience in Europe. At the time of writing in the autumn of 2017, important institutions such as the IMF and the World Bank do not rule out another financial crisis before we have fixed the problems and flaws of the global financial system⁵⁵. Lessons may have not been learnt. Next time it might be even worse.

In a third place, it is regrettable that the EU is self-referential and does not refer explicitly nor take into account the G20 High-level Principles on Financial Consumer Protection and does not mention either the work of this G20/OECD Task Force to implement in practice international standards of financial consumer protection⁵⁶

10. Conclusions

In view of the above, it is argued that the MCD represents some further EU/EEA legislation in the field and is certainly an improvement but fails to solve all questions and create a leading novel model in the world. It is unclear whether the principles of *ex-ante* information and responsible lending and the framework created by the European legislator will constitute a safety net when the next crisis arrive. Too many other important issues have also been neglected. The 2008 global financial crisis and 2010 European crisis showed the need for more effective financial consumer protection measures as they face more sophisticated and complex financial markets and greater economic/financial risks difficult to foresee *ex-ante*. Since the European legislation is not exhaustive and the EU institutions are not leading the world in this field, the academia needs to rethink the matrix and mutual relationships between capitalism, money/credit, crisis, mortgage and consumer protection at European level. This is more important than ever in an era of uncertainty and transition into new models of finance and banking than deserve novel thinking and new approaches and policies.

⁵³ Key tension referred by Professor Perry Mehrling in his MOOC course "Economics of Money and Banking" (Columbia University) at the Coursera website: <https://www.coursera.org/learn/money-banking> (last accessed 20.11.2017).

⁵⁴ Galbraith, John Kenneth, *A short history of financial euphoria*, Penguin, 1998.

⁵⁵ See some of these warnings expressed by Christine Lagarde, Director of the International Monetary Fund (IMF) in 2015 and 2017 as reflected in UK online newspapers (last accessed 20.11.2017), <https://www.theguardian.com/business/2015/oct/07/next-financial-crash-is-coming-imf-global-stability-report> and <http://www.telegraph.co.uk/business/2017/09/19/next-financial-crisis-coming-corbbyn-combination-brexite-would/>.

⁵⁶ On the G20 High-level Principles on Financial Consumer Protection see the document available online at <https://www.oecd.org/g20/topics/financial-sector-reform/financialconsumerprotection.htm> (last accessed 20.11.2017). On the G20-OECD Task Force on Financial Consumer Protection see the document available online at <https://www.oecd.org/daf/fin/financial-education/g20-oecd-task-force-financial-consumer-protection.htm> (last accessed 20.11.2017).

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