

PRE-CONTRACTUAL INFORMATION IN CREDIT AGREEMENTS FOR CONSUMERS

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Abstract

The article provides an image to the point on information provided to consumers before the conclusion of a credit contract, starting with the importance of information and ending with the legal framework.

A high consumer protection may be achieved primarily through consumer information. The complexity of banking services but also the vulnerability of consumers in relation to the banks and the unbalanced relationship led to the need to develop specific legislation that clearly establishes the rights and obligations of the parties of a credit agreement for consumers. In this regard, in 2008, after many debates, Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers was adopted.

At national level, the Directive was transposed by the Government Emergency Ordinance no. 50/2010 on credit agreements for consumers. Taking into account national specificities, such as lack of experience of consumers in financial products, the irresponsible lending and the unfair practices of creditors, the national act includes wider provisions than the European Directive, such as those relating to fees limitations or those related to the calculation of the variable interest rate. Also the GEO no 50/2010 applies to all credit agreements concluded by consumers and creditors.

As regards the advertising, any advertisement shall include a series of standard information. Also, pre-contractual information is standard information, is provided to consumers 15 days before the contract is concluded and is transmitted through the "European Consumer Credit Information sheet Standard".

The article presents when, how and what information should be given to consumers and insists on the importance of annual percentage rate and to what consumers should pay attention in order to be able to compare different offers.

Keywords: *pre-contractual information, pre-contractual costs, credit agreement, lenders, distance contracts.*

1. INTRODUCTION

During the last years, a highly debated issue in Romania concerns consumer credits and, in particular, the risks associated with them, which make their presence felt after several years of borrowing. Different stakeholders from the market - consumers, banking institutions, state authorities - launch in various discussions or even organize in diverse structures, with the intention either to claim their rights or to defend their interests, and sometimes some interests do not necessary coincide with the legal rights. These discussions are oscillating from the stage of finding the guilty to finding a solution. Both of the tasks prove cumbersome. Consumers are accused of not reading the contract and of not being educated enough. Banking institutions are accused of failing to conduct proper creditworthiness assessment, and everybody remembers the period in which credit was given on the base of identity card; they are also accused of not offering the proper or the complete information to their clients, or that they took unilateral decisions, especially when it came to unjustifiable increasing interest rates and charges during the contact. Authorities are accused of delayed reactions. In turn, all find explanations.

The fact is that, at least at the level of the legislators, it became clear that the complete, correct and accurate information is the base of balanced contractual relations.

2. Content

Consumer information in the field of banking services concur in pursuit of a high level of consumer protection. The complexity and the importance of banking services offered to consumers as well as the inferior position in which consumers usually are, led to the conclusion, both at European and national level, that special legislation is needed in order to protect consumers – natural persons.

The legislation protects the *average consumer* which is defined by the judgments of the Court of Justice of the European Union as being reasonably well informed and reasonably observant and circumspect, taking into account social, cultural and linguistic factors. Nevertheless, even the average consumer is the weaker and vulnerable part from a contract in comparison with a creditor taking into account the consumer's level of knowledge and his bargaining and economic power.

Moreover, recent empirical research in behavioural economics shows that factors influencing the way individuals interpret and act upon information are more sophisticated than once thought. It is a truism to mention that the consumer is dependent on the information provided by the creditor when taking the decision to conclude a contract.

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European legislation

At European level, in April 2008, Directive 2008/48/EC on credit agreements for consumers (the "Consumer Credit Directive") was adopted. The Directive aims to ensure a high level of consumer protection by focusing on transparency and consumer rights. It stipulates that a comprehensible set of information should be given to consumers in good time, before the contract is concluded and also as part of the credit agreement. In order to allow consumers to compare more easily the various offers and to better understand the information provided, creditors have to provide pre-contractual information in a standardised form (Standard European Consumer Credit Information). Moreover, they will also provide consumers with the Annual Percentage Rate of Charge (hereinafter called "APR"), which is a single figure, harmonised at EU level, representing the total cost of the credit.

National legislation

Directive 2008/48/EC was transposed into national legislation by Government Emergency Ordinance no 50/2010 (hereinafter called "GEO 50/2010") on credit agreements for consumers.

Low financial literacy of Romanian consumers during the past period, their lack of experience in financial products, the irresponsible lending and the unfair practices of creditors made necessary that the national legislator impose specific national measures to counterbalance the above-mentioned problems.

With certain exceptions, strictly defined by law, the legal provisions are applicable to all credit contracts concluded between consumers and creditors after the entry into force of GEO 50/2010. Therefore, among others, credit agreements for personal needs and real estate or mortgage contracts are also included, without there being any limit to the granted amount.

GEO 50/2010 regulates the information that should be provided to consumers in different stages – advertising, pre-contractual and contractual, and also issues related to interest and charges.

Information at early stages

Applying the principle that it is easier to prevent than to cure later, it is important for consumers to be the beneficiaries of all useful information before making a decision and concluding the contract. Only in this way, consumers can make appropriate choices for their needs.

Advertising

Standard information is required to be included in any form of advertising - radio, TV, newspapers, etc.

Standard information shall specify, by means of a representative example, the following:

- the fixed and/or variable borrowing rate of the credit, together with information on any charges included in the total cost of credit;
- the total amount of credit;

- the annual percentage rate;
- duration of the credit;
- in the case of a credit in the form of deferred payment for a specific good or service, the purchase price and the amount of any advance payment;
- if applicable, the total amount payable by the consumer and the value of the rates.

In any kind of advertising, the information must be written in a clear, concise, visible and easy to read, in the same visual field and with characters of the same size.

If the conclusion of a contract regarding an ancillary service relating to the credit agreement, particularly an insurance, is compulsory to obtain the credit itself or to obtain it according to the terms and conditions, and the cost of that service cannot be determined in advance, the obligation to conclude such a contract is also stated clearly, concise and visible, along with the annual percentage rate.

The information should be presented in a way that does not distort the economic behaviour of consumers or is not likely to distort the economic behaviour with regard to the product of the average consumer whom it reaches or to whom it is addressed, and should respect the requirements of professional diligence.

Pre-contractual information - when, how and what?

When?

According to GEO no 50/2010, information should be provided enough time in advance, but not less than 15 days before the consumer concludes a credit agreement. The 15-days may be reduced by written consent of the consumer.

How?

Pre-contractual information must be provided on paper or on any other durable medium, written clearly and easy to read, using the Times New Roman font, 12p minimum. If the information is written on paper, the paper color of the drawn form must be in contrast with the font used;

Lenders must use "the Standard European Consumer Credit Information". Any additional information which the creditor may provide to the consumer must be provided in a separate document that can be attached to the "Standard European Consumer Credit Information form".

In addition to the "Standard European Consumer Credit Information form", the consumer shall be provided, on request and free of charge, a copy of the draft credit agreement.

Pre-contractual information must be written so as not to mislead consumers through the use of technical expressions, legal or specific to banking area, using abbreviations or initials of certain names, except as provided by law or common language. The technical terms shall be explained at the consumer's request, in writing, at no additional charge.

Explanations should include at least the following:

- explaining of the pre-contractual information;
- the essential characteristics of the products proposed and the specific effects they may have on the consumer;
- an explanation of costs that are part of the total cost of credit to the consumer, so that consumers understand what they pay;
- the consequences of not paying for the consumer.

Creditors should be able to prove that the pre-contractual information was received by consumers.

What?

In order to meet its role of offering the consumer the possibility make the best choice, consumers should be aware that it is important to shop around asking the offers of different credit institutions. It is essential to ask for the personalized offer, meaning for exact the amount and period one wants (and can) to borrow. In this situation, the Standard European Consumer Credit Information form offered by different creditors will enable consumers to compare the data.

Once this learned, consumers should read carefully all the information of the standard form. Before mentioning the information provided in the standard form, I would like to call the attention to one key element – the annual percentage rate - APR.

APR is the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit. APR encompasses all the known costs for consumer like the interest rate, the charges and so on. APR is not just a simple addition of those costs, but it is calculated according to a mathematical formula used by all creditors from the Member States.

APR is an useful comparison tool but only under the condition to obtain personalized information from creditors on similar offers - meaning the same amount, the same duration of the contract, the same number of rates, the same type of interest. APR changes if the values of one element of the credit offer changes.

In case of credit offers with fixed interest rate, APR will be the same during the whole period. However, in the case of variable interest rate, the value of the APR will be available only at the moment of calculation.

The information of the “Standard European Consumer Credit Information form”:

- the type of credit;
- the identity and the address of the headquarter and of the office of the creditor as well as, if applicable, the identity and geographical address of the headquarter and/or of the office, or, if applicable home address of the credit intermediary involved;
- the total amount of credit and the conditions governing the drawdown;
- the duration of the credit agreement;
- in the case of a credit in the form of deferred

payment for a specific good or service and linked credit agreements, that good or service and its price;

- the borrowing rate;
- the conditions governing the application of the borrowing rate, calculation method of the the borrowing rate, as well as the periods, conditions and procedure for changing the borrowing rate and if different borrowing rates apply in different circumstances, the above mentioned information on all the applicable rates;

• the annual percentage rate of charge and the total amount payable by the consumer, illustrated by means of a representative example mentioning all the assumptions used in order to calculate that rate; where the consumer has informed the creditor of one or more components of his preferred credit, such as the duration of the credit agreement and the total amount of credit, the creditor shall take those components into account;

• if a credit agreement provides different ways of drawdown, with different charges or borrowing rates it shall indicate that other drawdown mechanisms for this type of credit agreement may result in higher annual percentage rates of charge

• the amount, number and frequency of payments to be made by the consumer and, where appropriate, the order in which payments will be allocated to different outstanding balances charged at different borrowing rates for the purposes of reimbursement

• where applicable, the charges for maintaining one or several accounts recording both payment transactions and drawdowns, unless the opening of an account is optional, together with the charges for using a means of payment for both payment transactions and drawdowns, any other charges deriving from the credit agreement and the conditions under which those charges may be changed;

• existence of taxes, fees and costs which the consumer has to pay in connection with the conclusion, advertising and/or recording the credit agreement and ancillary documents, including notary fees;

• the obligation, if any, to enter into an ancillary service contract relating to the credit agreement, in particular an insurance policy, where the conclusion of such a contract is compulsory in order to obtain the credit or to obtain it on the terms and conditions marketed;

• the interest rate applicable in the case of late payments and the arrangements for its adjustment, and, any charges payable for not compliance with the contract;

• a warning regarding the consequences of missing payments. The warning must contain the terms for reporting to the credit bureau and the minimum time at which the creditor may initiate foreclosure procedure;

- the sureties required;
- the existence or absence of a right of withdrawal;

- the right of early repayment, and, where applicable, information concerning the creditor's right to compensation and the way in which that compensation will be determined;
- the consumer's right to be informed immediately and free of charge of the result of a database consultation carried out for the purposes of assessing his creditworthiness;
- the consumer's right to be supplied, on request and free of charge, with a copy of the draft credit agreement;
- consumer's right to receive a free copy of the draft credit agreement in case of mortgage loans;
- if applicable, the period of time during which the creditor is bound by the pre-contractual information.

Pre-contractual information requirements for certain credit agreements in the form of an overdraft facility

The legal provisions also apply to “overdraft facilities” and taking into account the nature of these products, specific pre-contractual information is mentioned:

- the type of credit agreement;
- the identity and geographical address of the creditor as well as, if applicable, the identity and geographical address/ office of the credit intermediary involved;
- the total amount of credit;
- the duration of the credit agreement;
- the borrowing rate;
- the conditions governing the application of that rate, calculation method, any applicable costs from the moment of concluding the credit agreement and conditions under which those charges may be changed;
 - the annual percentage rate of charge, illustrated by means of representative examples mentioning all the assumptions used in order to calculate that rate;
 - the conditions and procedure for terminating the credit agreement;
 - in the case of credit agreements as “overdraft” an indication that the consumer may be requested to repay the amount of credit in full at any time;
 - the interest rate applicable in the case of late payments and the arrangements for its adjustment, and, where applicable, any charges payable for default;
 - the consumer's right to be informed immediately and free of charge, of the result of a database consultation carried out for the purposes of assessing his creditworthiness;
 - in the case of linked credit agreements, information about the charges applicable from the time such agreements are concluded and, if applicable, the conditions under which those charges may be changed;
 - if applicable, the period of time during which the creditor is bound by the pre-contractual information.

Pre-contractual information in case of distance contracts

In the case of voice telephony communications, the description of the main characteristics of the financial service to be provided shall include at least the following:

- the total amount of credit and conditions governing the borrowing;
- the duration of the credit agreement;
- in case of a credit in the form of deferred payment for a specific good or service or in the case of linked credit agreements, that good or service and its cash price;
- the borrowing rate;
- the conditions governing the application of borrowing rate, calculation method, as well as the periods, conditions and procedures for changing the borrowing rate and, if different borrowing rates apply in different circumstances, the abovementioned information in respect of all the applicable rates;
 - the amount, number and frequency of payments to be made by the consumer and, where appropriate, the order in which payments will be allocated to different outstanding balances charged at different borrowing rates for the purposes of reimbursement;
 - the annual percentage rate of charge, illustrated by means of representative examples;
 - the total amount payable by the consumer.

If the agreement has been concluded at the consumer's request using a means of distance communication which does not enable the information to be provided, the creditor shall immediately after the conclusion of the credit agreement fulfill his obligations by providing the pre-contractual information using the form “ “Standard European Consumer Credit Information””.

In the case of voice telephony communications and where the consumer requests that the overdraft facility be made available with immediate effect, the description of the main characteristics of the financial service shall include at least the following elements:

- the total amount of credit;
- the borrowing rate;
- the conditions governing the application of that rate, its calculation method, the charges applicable from the time the credit agreement is concluded and the conditions under which those charges may be changed;
 - the annual percentage rate of charge, illustrated by means of representative examples mentioning all the assumptions used in order to calculate that rate;
 - for the credit agreements which are granted in the form of an overdraft, an indication that the consumer may be requested to repay the amount of credit in full at any time;
 - the interest rate applicable in the case of late payments and the arrangements for its adjustment, and, where applicable, any charges payable for default.

Pre-contractual costs

For mortgage credit agreement, the creditor shall also inform consumer that he has to pay in pre-contractual stage only the following expenses:

- expenditure relating to preparation of loan application;
- the estimated costs related to the mortgage and sureties evaluation.

In all cases, the creditor has the right to perceive a charge for analyzing the file only of the credit was granted.

Evaluation of the file

Besides the pre-contractual information, it is also important for consumers to know the period during which the creditor must evaluate the credit file. According to the national legislation, within 30 days of submission of the credit file, but not more than 60 days after submission of the request for credit, the

creditor shall respond in writing to the consumer or the consumer's express request, the other form of consumer choice and accepted by the lender on or not to grant credit.

On credit receipt and other documents required, the financial service provider is obliged to immediately hand the consumer a written, dated, signed and registration numbered paper containing the lender's confirmation that he received all documents required by the granting of the credit.

3. Conclusions

In conclusion, information and knowledge are vital for consumers and, as Benjamin Franklin said "*An investment in knowledge pays the best interest.*" Nevertheless, education is the one that empowers consumers to benefit of the various offers of the market.

References

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