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EU COST CAPS: ONE STEP FORWARD TWO STEPS SIDEWAYS TO SUBSTANTIVE HARMONISATION OF CONSUMER CREDIT LAW

Abstract

This paper provides a critical analysis of Article 31 of the Proposal for a Directive on Consumer Credits (Proposal) of June 30, 2021, that requires Member States to introduce caps on cost of credit, on the interest rate and/or the total cost of credit to the consumer and/or the annual percentage rate of charge. Although this landmark change represents an important further step away from (over)reliance on information as a means of protection, there are two 'sideways steps' in the Proposal. First, it is unclear what are the constituent elements of the cap, especially whether loan extension fees, default interest and default fees are part of the cap. Second, the provision is unclear what legal tools can be used as a 'cap'. Although the Proposal may have in mind fixed caps, traditional general principles of laesio enormis and usury may be acceptable. It is argued that without clarification, these uncertainties are bound to lead to different understandings in Member States compromising the effectiveness of Article 31 as a harmonizing measure. The current approach only leads to 'formal harmonisation' leaving large scope for different interpretations; whereas the proposal should strive to achieve 'substantive' harmonization, which more fully unpacks the cap requirements along the suggestions in this paper to improve certainty, the degree of harmonization, fairness, and consumer confidence.

I.INTRODUCTION

This paper provides a critical analysis of the proposed future EU consumer credit regime. On 30 June 2021 the EU Commission presented its Proposal for a Directive on Consumer Credits (Proposal)[1] suggesting extensive amendments[2] to the current 2008/48/EC Consumer Credit Directive (CCD).[3] Among the most significant changes is the proposed Art. 31, requiring Member States (MS) to introduce or maintain caps on the cost of credit:

MS shall introduce caps on one or more of the following: (a)interest rates applicable to credit agreements; (b)the annual percentage rate of charge (APR); (c)the total cost of the credit to the consumer (TCC).

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[1]Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, COM(2021) 347 final available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2021:347:FIN> accessed 2 March 2022.

[2] Ibid, Impact assessment. See also ICF Consulting Services, Study on possible impacts of a revision of the CCD (EU Commission, May 2021) available at https://ec.europa.eu/info/files/consumer-credit-review-supporting-study-and-annexes_en accessed 1 March 2022.

[3] Directive 2008/48/EC on credit agreements for consumers [2008] OJ L 133/08, 66-92.

It is shown here that the requirement to place substantive caps on the cost of credit is an important further step away from (over)reliance on information for consumer decision-making in EU credit law. This step is ground-breaking with substantive caps previously reserved for national regulatory choices.[4] The Court of Justice of the European Union (CJ) had already held that substantive caps were *permitted*;[5] but the Proposal now *requires* MS to impose these. This substantive contract regulation can be called 'product intervention',[6] a measure that regulates the terms of the contract, by setting substantive standards of suitability and fairness.[7] Unlike information provision, which alert and inform consumers on the substantive terms of the contract; product intervention sets these substantive terms e.g., by providing cost caps.[8]

However, it is also shown here that there are two significant uncertainties 'sideways steps' in the Proposal. First, it is unclear precisely what are the constituent elements of the cap. If the cap is on the interest rate, the answer is straight forward, the cap is comprised of the rate of interest only. However, if the cap is on the TCC (all costs, including interest, commissions, taxes and other main or ancillary fees the consumer must pay to obtain the credit);[9] and/or APR (the TCC expressed as an annual percentage of the total amount of credit)[10] that contain additional charged to the rate of interest, it is much less clear, especially whether loan extension fees, default interest and default fees are part of the TCC and the APR. It is suggested that these uncertainties are addressed either by amending the Proposal during the legislative process or in a separate Guidance document issued by the Commission. Second, the provision is far from clear on exactly what existing legal tools can be used as a 'cap'. It is shown that the Proposal may have in mind fixed caps, but that nevertheless traditional general principles of *laesio enormis* and usury may be acceptable. It would be preferable to signal explicitly in further drafts or separate Guidance which caps are and are not permitted, and what conditions apply in this regard.

Finally, it is argued that without clarification, these uncertainties are bound to lead to different understandings and approaches in MS, therefore compromising the effectiveness of the Art. 31 cap requirements as a harmonizing measure that aims to achieve a high level of consumer protection and develop the internal market in consumer credit. Two new

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[4] See e.g., N. Reich, 'Crisis or Future of European Consumer Law?', *The Yearbook of Consumer Law 2009* (Routledge 2008). 43; H.-W. Micklitz, 'Introduction – Social Justice and Access Justice in Private Law' in H.-W Micklitz (ed.) *The Many Concepts of Social Justice in European Private Law* (Edward Elgar 2011) 36–38; S. Weatherill, 'The Constitutional Competence of the EU to Deliver Social Justice' (2006) 2(2) *European Review of Contract Law* 136.

[5] C-779/18 Mikrokasa and Revenue Niestandaryzowany Sekurytyzacyjny Fundusz Inwestycyjny Zamknięty, EU:C:2020:236; C-686/19 SIA "Soho Group", EU:C:2020:582.

[6] E.g. A. Fejős, 'Social Justice in EU Financial Consumer Law' (2019) 24 Tilburg Law Review 68, 69.

[7] Ibid.

[8] For a broader understanding of product intervention as '*regulatory interventions focused on products' such as ongoing product governance, rules targeting product features, rules limiting sales of products and setting … down specific conditions of sale.*' See Financial Services Authority, 'Product Intervention' (DP 11/1, 2011) 6 <www.fca.org.uk/publication/discussion/dp11_01.pdf> accessed 1 March 2022.

[9] Art. 3 (5) Proposal.

[10] Art. 3 (7) Proposal.

conceptions of harmonization are suggested to explain alternative approaches in this and in future harmonization initiatives: 'formal' harmonization, the current approach, that leaves a large scope for different interpretations; and 'substantive' harmonization, which more fully unpacks along the suggestions in this paper what is expected at national level, and improves certainty, the degree of harmonization, fairness, and consumer confidence.

Regulating consumer credit is very important. Consumer credit makes goods and services (e.g. a new fidge or a holiday) avaiable to consumers who do not have (sufficient) savings and provides immediate access to those who prefer not to save. As such, access to credit is increasingly considered essential,[11] a comparison often being made with services of general interest, services without which it is impossible to live in a modern society.[12] Indeed, consumer credit is an important component of consumers' lives,[13] and shows a steady upward trajectory of growth in the EU.[14] However, consumer credit also carries the great risk of excessive debt accumulation, potentially leading to sustained inability of debt-repayment or over-indebtedness. This in turn may trigger associated detriments of a financial nature such as the lack of access to affordable loan or financial excusion, and a non-financial nature such as stress and mental health problems.[15] One of the reasons for debt accumulation may be that the product has excessive interest rates and fees.[16] This problem may be tackled by informing consumers of the cost of the loan, or by a product intervention measure, imposing a cap, such as the ones proposed in Art. 31. Product regulation goes in the heart of the 'bargain'. Carefully defined rules can not only enable EU consumers to access cheaper loans, but would also make them safer; decreasing the chances of payment default and associated detriment such as overindebtendess and financial exclusion.[17] Hence, this reserach provides implortant practical recommedations that could improve the lives of more than 400 million EU consumers.[18] It also provides significant theoretical and policy contributions: on the shift from an information paradigm to a more protective, social justice-oriented approach;[19] and on entirely new ways of thinking of

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[11] See e.g. World Bank, 'Finance for All? Policies and Pitfalls in Extending Access' (World Bank, 2008) < https://openknowledge.worldbank.org/handle/10986/6905 > accessed 1 March 2022; E. Kempson, S. Collard, 'Developing a vision for financial inclusion' (Friends Provident Foundation, 2012) <www.fincan.co.uk/repository/uploads/sectionpdfs/95%20Developing%20a%20Vision%20for%20Financial%20Inclusion%20-%20Kempson%20&%20Collard%20March%202012.pdf> accessed 1 March 2022

[12] See e.g. I. Ramsay, 'Regulation of consumer credit' in G. Howells et al. (eds.), *Handbook of Research on International Consumer Law* (Edward Elgar, 2018) 347.

[13] In 2011 average debt per capita ranged from 212 euros in Lithuania to 4111 euros in Cyprus. Report from the Commission to the European Parliament and the Council on the implementation of Directive 2008/48/EC on credit agreements for consumers, COM (2014) 259 final, 6.1 available at <https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:52014DC0259> accessed 1 March 2022

[14] EBA Consumer Trends Report 2020/21, EBA/REP/2021/4 (EBA, 2021) 17 <available at https://www.eba.europa.eu/eba-assesses-consumer-trends-20202021> accessed 1 March 2022

[15] Fejős (n 6) 76.

[16] EBA (n 14) 21-22.

[17] A. Fejős, 'Achieving Safety and Affordability in the UK Payday Loans Market' (2015) 38 *Journal of Consumer Policy* 181.

[18] Facts and figures on life in the European Union, available at < https://european-union.europa.eu/principles-countries-history/key-facts-and-figures/life-eu_en> accessed 1 March 2022

[19] See Fejős (n 6).

harmonization. Finally, given the universal challenge of creating effective rules on the cost of loans, the arguments made here can contribute to legal policy beyond the EU.[20]

Consumer credit law is a significant part of European consumer law and has therefore been subject to considerable scholarly contribution. Consumer credit is used as an example within broader financial consumer law to show how we might rethink the notion of consumer vulnerability[21] and to demonstrate failings in efforts to improve financial literacy.[22] Substantial work focused on the CCD as a perfect example of the information paradigm of EU consumer law,[23] and on the consequences and prevention of over-indebtedness.[24] Within the EU and beyond, attention has been given to policy tensions and trends between information paradigm and product regulations,[25] and to the effectiveness of various product regulation tools in the context of high-cost credit[26] and within the relationship between fixed rate ceilings and traditional legal principles such as usury.[27] Naturally, the cost of credit is also researched within other disciplines, such as economics and finance.[28]

However, despite the rich and diverse literature, no one has commented on EU law's recent and very substantial move from information paradigm to substantive regulation of the cost of credit. Neither has there been work on the associated 'technical' questions as to precisely what charges are covered with these rules, and what tools should be used to have caps that will provide a high level of protection for consumers and help creating the internal market in consumer credit. The discrepancies and problems on the TCC and the APR were not raised before, even though these notions were part of the CCD's information approach.[29] This paper

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[20] See e.g. Y. M. Atamer, P. Pichonnaz (eds.) *Control of Price Related Terms in Standard Form Contracts* (Springer, 2020); Financial Conduct Authority, Proposals for a price cap on high-cost short-term credit, Consultation Paper (CP 14/10, 2014) available at https://www.fca.org.uk/publication/consultation/cp14-10.pdf

[21] See e.g., P. Rott, 'A Plea for Special Treatment of Financial Services in Unfair Commercial Practices Law' (2013) 2 *Journal of European Consumer and Market Law* 61. I. Domurath, 'The Case for Vulnerability as the Normative Standard in European Consumer Credit and Mortgage Law – An Inquiry into the Paradigms of Consumer Law' (2013) 3 *Journal of European Consumer and Market Law* 124.

[22] See e.g., V. Mak, J. Braspenning, 'Errare Humanum Est: Financial Literacy in European Consumer Credit Law' (2012) 35 *Journal of Consumer Policy* 307.

[23] See e.g. J. Luzak, M. Junuzović, 'Blurred Lines: Between Formal and Substantive Transparency in Consumer Credit Contracts' (2019) 8 Journal of European Consumer and Market Law 97. C. Garcia Porras, W. van Boom, 'Information Disclosure in the EU Consumer Credit Directive: Opportunities and Limitations' in J. Devenney. M. Kenny (eds.), *Consumer Credit*, *Debt and Investment in Europe* (CUP, 2012).

[24] See e.g. O. O. Cherednychenko, J.-M. Meindertsma, 'Irresponsible Lending in the Post-Crisis Era: Is the EU Consumer Credit Directive Fit for Its Purpose?' (2019) 42 *Journal of Consumer Policy* 483. H-W. Micklitz, I. Domurath (eds.), *Consumer Debt and Social Exclusion in Europe* (Ashgate, 2015).

[25] O. O. Cherednychenko, 'Freedom of Contract in the Post-Crisis Era: Quo Vadis?' (2014) 10 *European Review of Contract Law* 390; I. Ramsay, 'Changing Policy Paradigms. of EU Consumer Credit and Debt Regulation in D. Leczykiewicz, S. Weatherill (eds.), *The Images of the Consumer in EU Law* (Hart 2016); Fejős (n 6).

[26] See e.g. Fejős (n 17); N. J. Howell, 'Small Amount Credit Contracts and Payday Loans: The Complementarity of Price Regulation and Responsible Lending Regulation (2016) 41 (3) *Alternative Law Journal* 174.

[27] See e.g. Atamer, Pichonnaz (n 19).

[28] See e.g. E. Berlinger 'Why APRC is misleading and how it should be reformed' (2019) 7 Cogent Economics and Finance; P. Temin, H.-J. Voth, 'Interest Rate Restrictions in a Natural Experiment: Loan Allocation and the Change in the Usury Laws in 1714 (2008) 118 *The Economic Journal* 743; T.A Durkin, G. Elliehausen 'Assessing the Price of Short-Term Credit' (November 6, 2013) available at <https://ssrn.com/abstract=2402197> accessed 1 March 2022.

[29] See Arts. 3(g), 3(i) and 19(2) CCD.

come when there is still time for its recommendations (on the charges that should be covered, and the appropriate capping techniques) to influence the EU's long and complex legislative process of adopting the new directive.

Another important contribution of this research is the development of the concepts of formal and substantive harmonization. Harmonization of consumer laws has generated considerable academic debate. This has focused on the EU's competence to impose standards in consumer law and protection; on the dichotomy between and relative benefits of minimum and full harmonization; and the kinds of provisions in consumer law that are subject to minimum and full harmonization.[30] This paper adds a new way of looking at full harmonization by introducing the notions of formal and substantive harmonisation. Although these notions are developed in the context of consumer credit, they may be more widely applicable in other areas of consumer law that are subject to full harmonization or indeed in any area of law where a dichotomy between form and substance is likely to arise.[31]

In the following the paper first shows the important shift to greater consumer protection via product intervention (section 2). It then shows that by not being clearer on what costs are covered (section 3) and what tools could be used as caps (section 4), the harmonization, internal market and protection goals are compromised (section 5). Finally, the conclusion summarizes the findings and provides recommendations.

II.ONE STEP FORWARD: FROM INFORMATION PARADIGM TO PRODUCT REGULATION

Resting on the premise that financial products are difficult to understand because of their innate complexity and non-transparent presentation, the current CCD requires supply of the necessary information for informed decision making.[32] In this respect, the CCD is overwhelmingly information oriented, and is often depicted as a perfect example of the 'information paradigm' of EU consumer law.[33] Within this approach, the rules target information asymmetries between creditors and consumers, to enable consumers to make informed decisions. The ultimate decision-making is left to consumers, who (armed with the information provided) are assumed to be able to make rational choices between various credit products.[34]

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[30] See e.g. V. Mak, 'Full Harmonization in European Private Law: A Two-Track Concept' (2012) 20 *European Review of Private Law* 213. H-W. Micklitz, N. Reich, 'Crònica de una muerte anunciada: The Commission Proposal for a "Directive on Consumer Rights"' (2009) 46 *Common Market Law Review* 471; T. Wilhelmsson, 'The Abuse of the "Confident Consumer" as Justification for EC Consumer Law' (2004) 27 *Journal of Consumer Policy* 317; G. Howells, N. Reich 'The current limits of European harmonisation in consumer contract law' (2011) 12(1) *ERA Forum* 39; Jan Smits 'Full harmonisation of consumer law? A critique of the draft directive on consumer rights' (2010) 1 *European Review of Private Law* 5.

[31] E.g. substance over form is an accounting principle. P.A. Holgate, E. Buckley, *Accounting Principles for Non-Executive Directors* (CUP, 2009).

[32] Report on the operation of Directive 87/102 for the approximation of laws, regulations and administrative provisions of the Member States concerning consumer credit, COM(95) 117 final available at <https://op.europa.eu/en/publication-detail/-/publication/4f1e8c63-0090-4a97-b734-0fc93575e029> accessed 1 March 2022.

[33] See (n 23).

[34] O. O. Cherednychenko, J.-M. Meindertsma, 'Consumer Credit: Mis-selling of Financial Products' (EU Parliament, 2018) 6 available at

Cost related provisions are part of this general information approach. The CCD already contains the terms 'interest', 'TCC' and 'APR', adopting an identical approach to their definition as the new Proposal.[35] Certain information is to be provided in advertising, as part of the contract, as pre-contractual standard information, or personalized with explanations.[36] These information rules would remain in place.[37]

Although the CCD does not *require,* it *permits* MS to introduce product regulation in form of caps on the cost of credit.[38] The CCD contains a complex structure of provisions. Some credit products or some aspects of credit products are fully within the scope of the CCD's full harmonization regime, some are partially, and some are not at all.[39] Where no such harmonised provisions exist, the MS remain free to maintain or introduce national legislation.[40] Crucially it has emerged that while information provisions are full harmonisation, meaning that MS can only impose the information requirements specified in the CCD; *substantive product regulation* in form of cost caps is entirely beyond the scope of the CCD, and MS are free to impose these.[41] Indeed, in the absence of EU rules 23 MS have already adopted cost-caps.[42]

Art. 31 of the Proposal now mandates MS to introduce or maintain cost caps on the interest rate, the TCC and/or the APR. According to Rec. 65 of the Proposal, cost caps are already a common practice in a number of MS, and such 'capping has proved beneficial for consumers'. The Proposal does not go any further in explaining the proposed cap. However, the preparatory documents give a general idea of the Commission's thinking. The idea is that caps should benefit consumers by reducing detriment, building trust and improve social inclusion; benefit businesses by creating a level playing field within and across MS; and benefit society at large by preventing over-indebtedness and improving social inclusion.[43]

Implicit in the new approach seems to be the acceptance of the serious limits of the information in consumer credit that empirical and theoretical research has repeatedly demonstrated. Consumer credits are abstract, intangible financial products that can only be evaluated based on the information received, and that require legal and financial knowledge

<www.europarl.europa.eu/RegData/etudes/STUD/2018/618997/IPOL_STU(2018)618997_EN.pdf Ibid> accessed 1 March 2022; P. Norwood, A. Molinari 'New data on consumer credit mis-selling, poor lending practices expose EU Consumer Credit Directive (CCD) shortfalls' (Finance Watch, 2021) available at <https://www.finance-watch.org/publication/consumer-credit-market-malpractices-uncovered/> accessed 1 March 2022.

[35] See Art. 3(g), 3(i), and 19(2) CCD. Annex V Proposal.

[36] See especially Arts. 4, 5 and 10 CCD.

[37] See Arts. 7-10 Proposal.

[38] Mikrokasa (n 5); Soho Group (n 5).

[39] See Art. 2 CCD.

[40] Rec. 9 CCD.

[41] Soho Group (n 5); Mikrokasa (n 5).

[42] Mikrokasa (n 5).

[43] Commission Staff Working Document Impact Assessment Report Accompanying the Proposal for a Directive of the European Parliament and of the Council on consumer credits, SWD(2021) 170 final, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018SC0052%2801%29>accessed 1 March 2022 .

for full understanding.[44] Information thus needs to be carefully selected, to avoid information overload; and carefully presented, to avoid behavioural pitfalls of consumers not focussing on the most important information. Even then, consumers often fail to note the information communicated to them,[45] they often do not understand it,[46] and they are not rational decision-makers.[47] On the contrary, consumers' behaviours are typically biased, e.g. consumers may be overconfident in their ability to repay the loan.[48] This enabled creditors to disclosure and frame pricing information in such a way as to influence consumers' decision making,[49] often misleading consumers on the suitability of products.[50]

Product regulation is also justified by the complexity of consumer credit that makes hard for information to genuinely inform consumers. Even loans of a fairly low amount have a complex price structure.[51] In addition to the rate of interest, credit triggers additional fees and charges presented in a wide range of forms (set-up costs, maintenance costs, fees linked to payment transactions and drawdown, fees for ancillary services, etc.).[52] Most of these are ancillary to the core obligation to pay interest; and so less likely to be focussed on in consumers' decision making. Yet these charges are often very high. In *Mikrokasa*, the consumer borrowed around 940 euros at a 7% annual rate of interest for an amount of around 86 euros. The consumer also paid around 139 euros in arrangement fees and 790 euros in administrative fees.[53] Overall, ancillary fees came to more than 10 times the interest charges. Indeed, research on high-cost credit has shown that consumers tend to underestimate the expense of ancillary charges. They fail to think about how these can accumulate, focusing on only one part of the pricing structure even when it has several elements.[54] Particularly problematic ancillary

[44] See e.g. D. Llewellyn, 'The Economic Rationale for Financial Regulation' (Financial Services Authority Occasional Paper 1, 1999) 32-40 <https://www.fep.up.pt/disciplinas/pgaf924/PGAF/Texto_2_David_Llewellyn.pdf> accessed 1 March 2022.

[45] See e.g. O. Ben-Shahar, 'The Myth of the 'Opportunity to Read' in Contract Law' (2009) 5 *European Review of Private Law* 1; I. Ayres, A. Schwartz 'The no-reading problem in consumer contract law' (2014) 66 *Stanford Law Review* 545.

[46] See e.g. London Economics et al., 'Consumer vulnerability across key markets in the European Union' (EU Commission, 2016) 342-344 <https://ec.europa.eu/info/sites/info/files/consumers-approved-report_en.pdf> accessed 25 February 2022.

[47] See e.g. Ibid, 340-342.

[48] See e.g. M.M.G. Faure, H.A. Luth 'Behavioural economics in unfair contract terms, cautions and considerations' (2011) 34 *Journal of Consumer Policy* 337.

[49] M. Bertrand, A. Morse '*Information disclosure, cognitive biases and payday borrowing'* (2011) LXVI (6) *The Journal of Finance* 1865.

[50] See e.g., Cherednychenko, Meindertsma (n 33).

[51] Financial Conduct Authority, High-cost Credit Review> Overdrafts, Consultation Paper CP 18/13 4.29 et seq. available at https://www.fca.org.uk/publication/consultation/cp18-13.pdf

[52] U. Reifner et al., 'Study on the interest rate restrictions in the EU' 3 (Publications Office of the EU, 2010) <https://op.europa.eu/en/publication-detail/-/publication/46a336d0-18a0-4b46-8262-74f0e0f47eb3> accessed 14 March 2022.

[53] Mikrokasa (n 5) 23.

[54] Atticus, Consumer research on overdrafts (Financial Conduct Authority, 2018) 54 available at <https://www.fca.org.uk/publication/research/consumer-research-on-overdrafts.pdf> accessed 1 March 2022.

charges are charges that are contingent upon the occurrence of a particular event in the future, e.g. consumer default.[55]

Even if some consumers could make informed decisions using legally mandated information, another reason for more substantive product regulation is that some types of consumer credit, especially those that are at high cost, are known to be used by less well-off consumers, who are less able to accommodate income or expenditure shocks.[56] Many consumers are dependent on this type of credit in their daily lives to cover essential grocery shopping or to pay for utility bills.[57] The vulnerability of these customers is exacerbated by their commonality of having had previous experience with various credit products[58] and having multiple expensive credit at the same time.[59] Many therefore struggle with debt problems.

Overall then the proposed compulsory cap rule marks a significant further step to recognising the limits of the information paradigm and the need for product regulation. It would be likely to make a significant practical difference. In some MS capping high-cost credit has already led to reduction in default or the complete disappearance of harmful products from the market (e.g. Belgium and Slovakia).[60]

One important feature of the proposal is that it does not insist that the same level of cap is placed on different credit products and on their different elements. This flexibility, supported by the industry,[61] recognises that the distinctive features of various products and services may require different approaches. There are a huge variety of credit products in terms of duration, rates, amounts, purpose, user demographic, other conditions etc.[62] A low interest personal bank loan should have a lower cap than a high-cost short term credit, which are by their very nature (and name) more expensive than personal loans. In addition, not all kinds of caps are suitable for all types of loans. For instance, research shows the APR is not the best cap for high-cost short term credit, loans with usually have high charges especially compared to the amount borrowed.[63] Some MS already have more caps in place for different kinds of loans, like Portugal.[64] There are also examples of having more than one cap on the same type of loan. For instance, in Sweden the TCC cannot exceed the total amount of loan and the maximum annual interest rate is capped at 40%.[65] However, caps are the most widely applied on high-cost credit.[66] This would not be able to continue. The Proposal applies to 'credit

[55] C. Willett, 'Re-theorizing consume law' (2018) 77 *The Cambridge Law Journal* 179, 203-206.
[56] Competition and Markets Authority, 'Payday lending market investigation, Final report' (CMA, 2015) 2.29 <https://assets.publishing.service.gov.uk/media/54ebb03bed915d0cf7000014/Payday_investigation_Final_report.pdf > accessed 25 February 2022.
[57] Ibid, 2.27.
[58] B. Rowe et al., 'Consumer credit research: payday loans, logbook loans and debt management services' 57 (ESRO, 2014) available at <https://www.fca.org.uk/publication/research/fca-esro-final-report-2014.pdf> accessed 1 March 2022.
[59] CMA (n 56) 5.27.
[60] Commission (n 43) 129.
[61] Reifner et al. (n 52) 132.
[62] Ibid. For instance, in 2011 Slovakia had 20 different credit products and 19 were very common in practice that compares to 7 common products in Germany. Commission (n 13) 6.2.
[63] Durkin, Elliehausen (n 28); Financial Conduct Authority (n 20) 1.15.
[64] Commission (n 43) 128.
[65] Ibid.
[66] Ibid.

agreements', defined as credit in the form of a 'deferred payment, loan or other similar financial accommodation..'.[67] There is no restriction to high-cost credit agreements, MS would need to intervene much more significantly across their credit sectors.

III. THE FIRST STEP SIDEWAYS: THE UNLCEAR CONTENT OF CAPS

The first problematic aspect of the proposed regime is that it is not always clear what specific costs, charges and fees fall under the caps. As shown above, credit contracts are complex, and contain numerous fees and charges in addition to the rate of interest. The new proposal is that MS may cap the interest rate and/or the TCC and/or the APR. It is clear what the basic interest rate is. However, it is unclear whether all or only some 'ancillary' fees and charges are included in the TCC and the APR.

A. The content of TCC

According to Art. 3(5) the TCC '*means all the costs, <u>including</u> [emphasis added] interest, commissions, taxes and any other kind of fees which the consumer is required to pay in connection with the credit agreement ... and which are known to the creditor, in the case of credit agreements, …, except for notarial costs; costs in respect of ancillary services relating to the credit agreement ... are also included….. where, in addition, the conclusion of a contract regarding such ancillary services is compulsory … to obtain the credit or to obtain it on the terms and conditions marketed.'* This wording, especially the use of the word 'including', signals that the list provided is not exhaustive. The question is therefore whether there may be other cost elements that can be said to contribute to the TCC, despite not being specified in Art. 3(5), and indeed whether there are other costs than notarial fees that are fully outside the scope of Art. 3(5)?

In interpreting Art. 3(g) CCD (the equivalent to Art. 3(5) Proposal[68]) the CJ ruled that the TCC is an autonomous EU law concept and should be interpreted in a uniform manner throughout the EU.[69] In interpreting Art. 3(g) the CJ favoured a broad approach,[70] suggesting that the TCC it should be inclusive of all fees and charges. The idea was that this was necessary to fulfil the consumer protection objective of the CCD.[71]

The proposed Art. 3 (5) definition refers to fees and charges for compulsory services that are ancillary to the main contractual obligation of the consumer, the payment of the interest.[72] This seems clearly to include, for instance, various administrative fees; but there is real uncertainty as to whether it includes loan extension fees and default interests and fees.

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[67] Art. 3 (3) Proposal.
[68] Annex V Proposal.
[69] Soho Group (n 5) 39.
[70] Mikrokasa (n 5) 39, see also C-143/13 Matei EU:C:2015:127, 48; C-127/15 Verein für Konsumenteninformation EU:C:2016:934, 35; C-383/18 Lexitor EU:C:2019:702, 23.
[71] Soho Group (n 5) 31.
[72] Verein für Konsumenteninformation (n 70) 34, see also C-377/14 Radlinger EU:C:2016:283, 84; C-602/10 SC Volksbank România EU:C:2012:443,65; Soho Group (n 5) 28.

1. Loan extension fees

In *Soho Group* the CJ ruled that the TCC must be interpreted to include the costs of any extension of the duration of credit, provided that two conditions are satisfied: first, that the precise conditions of the extension, including its duration, are laid down in the contract and, second, that the costs are known to the creditor.[73]

In its reasoning, the CJ considered the wording of Art. 3(g) (now Art. 3(5) of the Proposal) concluding that since the provision refers to *all* costs and only excludes notarial costs, the clear intention was only to positively exclude notarial costs and no other costs.[74] The CJ also examined the TCC's link with related notions, in particular, the APR. In specifying what costs are considered when calculating the APR, Art. 19(2) (now Art. 30(2) of the Proposal) excludes '*any charges payable by the consumer for non-compliance with any of his commitments'*. This led the CJ to conclude that loan extension fees are within the TCC, since they are not fees payable for contractual non-compliance.[75] On the contrary, loan extension fees are usually payable to avoid default as a form of non-compliance.[76]

On the requirement stipulated by the CJ and reflecting Art. 3 (g) CCD that to be covered loan extension costs must be *known to* the creditor. This was one of the aspects of disagreement between Soho Group and the Latvian court. The Regional Administrative Court held that when loans were extended, the costs associated with extensions became 'known costs'.[77] Soho Group however argued that knowledge should be determined at the time when the contract was concluded and not when the extension was actioned by the consumer.[78] When the contract is concluded the extension is only one of the options available to consumers upon the maturity of the loan instalments and therefore the payment of loan extension fees are not compulsory for obtaining or using the loan. Consumers can either pay the instalment, choose to default (and pay default fees), or choose to extend the loan by paying the loan extension fee. According to Soho Group, loan extensions are not known costs for the creditor; as the extension of the loan is conditioned upon the consumer's explicit request, the creditor's consent, and the consumer's payment of the associated fees.[79] The CJ noted that Art. 3(g) CCD does not specify that it is limited to fees that are necessary to obtain the credit or those payable at the time when the contract is concluded.[80] Moreover, the preamble of the CCD makes it clear that the TCC includes all costs which the consumer has to pay *in connection* with the credit agreement.[81] From this broad determination, the CJ concluded that the provision includes not only charges due at the time of contract conclusion, but also those that occur later during the performance of the contract.[82] This led the CJ to conclude that loan extension fees satisfied

[73] Soho Group (n 5) 54.
[74] Ibid, 28-29.
[75] Ibid, 40- 44.
[76] A. Fejős, 'From Information Provision to (Direct and Indirect) Product Intervention' (2021) 10 (5) Journal of European Consumer and Market Law 200.
[77] Soho Group (n 5) 19.
[78] Ibid.
[79] Ibid, 35-36.
[80] Ibid.
[81] Ibid, 32.
[82] Ibid, 33.

the relevant criteria: they were clearly identified or were identifiable based on the parameters provided in the contract, and this made them known to the creditor at the time when the contract was made.[83]

An important dimension of the above argument is that loan extensions are arguably optional.[84] Whilst the CCD clearly intended to include compulsory ancillary fees i.e., those that are necessary to obtain the credit, it does not specifically deal with a situation where the payment of ancillary fees are optional. Contextual interpretation could even conclude that optional fees should not be included in the notion of TCC. The above-mentioned Art. 19(2) CCD provides that costs associated with an obligation to open a bank account will be part of the APR, unless '*the opening of the account is optional and the costs of the account have been clearly and separately identified in the credit agreement*.' It is interesting that the CJ did not consider this, despite repeatedly referring to Art. 19 to support of its conclusions that loan extensions fees are part of the TCC.

It is clear from the reasoning of the CJ in *Soho Group* that it intended to provide a protective interpretation for consumers. This was arguably justified given the consumer protection objectives of the CCD, and the arguments made here as to the limits of information and the need for substantive caps to provide such protection.[85] Indeed, loan extensions are frequently used by consumers of high-cost credit. Soho Group, for instance, extended around half of the loans in its portfolio,[86] leading the referring national court to assert that loan extensions are not exceptional, rare, or unforeseeable.[87] The question is whether this protective approach is transferrable to the new consumer credit regime?

One important problem/uncertainty in transferring the protective approach adopted in *Soho Group* is that Proposal does not make any express reference to loan extension fees or the Soho Group case at all, whereas it refers to *Lexitor*, another important case on the CCD.[88] In addition, the Proposal contains an Art. 9 that has no equivalent in the current CCD.[89] Art. 9(2)(f) with reference to the provision of 'general information' to consumers clarifies that '*possible further costs, not included in the total cost of the credit*' but that are paid in connection with the credit contract, should also be separately indicated. This provision would suggest that Art. 3(5) Proposal is *not* inclusive of all costs, and that there may be other costs, including for instance loan extension fees, that are left entirely outside of the TCC. Could the insertion of Art. 9(2)(f) along with the failure to refer to the CJ in *Soho Group*, signal that the drafters intended to override the CJ on the matter of loan extension fees? It is quite possible, although at this point not entirely clear.[90] Art. 9(2) Proposal's purpose is to clarify the content of general information, rather than to interpret the meaning and the content of the TCC, but that does not necessarily mean that it could not be given some contextual role in relation to the latter. One way or the other, there is

[83] Ibid, 35-36.
[84] Ibid, 20.
[85] See section 2 above; also Fejős (n 76).
[86] C-686/19 Soho Group, Request for a preliminary ruling, 5.4.
[87] Ibid.
[88] Rec. 62 Proposal.
[89] Annex V Proposal.
[90] O. Larsson, 'Political and constitutional overrides: the case of the Court of Justice of European Union' (2021) 28(12) *Journal of European Public Policy* 1932.

significant uncertainty as to whether loan extension fees are indeed part of the TCC, and this should be clarified.

2. Default charges and default interest

There are various uncertainties surrounding the capping of default charges and interest payable upon default. The first uncertainty revolves around the basic notion of a 'default'. Generally, we could understand payment default as one or more missed payments or a late payment. The Proposal mentions both late payment[91] and default[92], and it seems to understand default in the sense of *late payment*.[93] It remains unclear whether one late payment is enough to trigger the consequences of default. The Proposal talks about 'late payments'[94] which would imply at least two late payments. It is quite possible this question was intended to be left for MS to regulate, but this would be important to explain.

In terms of *default charges*, the Proposal seems to take a broad approach to capture various possible charges consumers should pay upon default. Capping of default charges is in fact provided for expressly under Art. 35 on arrears and forbearance. First, Article 35(3) says that if MS allow creditors to impose charges 'arising from default' they may provide that these charges should be no more than what is necessary to compensate the creditor's costs incurred due to the default. In addition, Art. 35(4) then goes on to say that if 'additional charges' are allowed to be imposed, then MS must impose a cap on such charges. The drafters clearly intended to have covered here different events of default, but the result is very confusing without defining what is meant by default in each case. Arguably, Art. 35(3) relates to payment default of the main contractual obligation, payment of the loan instalment (interest alone or together with repayment of the portion of the borrowed capital) whereas Art. 35(4) regulates any other instances of default e.g., late payment of any ancillary charges. Before the final version of the new directive is adopted it would be important to clarify what is meant by the two provisions exactly.

Although default charges are regulated separately in Art. 35, it is also important to decide if they are covered under the TCC. What is part of the TCC would affect any cap on the TCC, and of course any cap on the APR which is calculated based on the TCC. Art. 3(5) Proposal refers to '*all the costs …. the consumer is required to pay in connection with the credit agreement'*, suggesting default charges are covered. However, a contextual interpretation, considering Art. 3(5) within the entire Proposal leads us to a different conclusion. Firstly, the above discussed Art. 35 deals with default charges separately, within arrears and forbearance. If the drafters intended default charges to be part of TCC, they should have expressly also included them into the scope of Art. 3(5). Moreover, we can also consider Art. 30(2) the provision detailing the calculation of the APR. The APR of course is calculated based on the TCC, so definitions of the APR may help in understanding the content of the TCC. Art. 30(2) provides: '*For the purpose of calculating the annual percentage rate of*

[91] E.g. Art. 10(3)(m).
[92] E.g. Art. 35.
[93] The Standard European Consumer Credit Information in Annex I sets put the 'Costs of late payment' as '*applicable interest rate and arrangements for its adjustment and, where applicable, default charges'.*
[94] See e.g., Arts, 10(3)(m), 11(2)(k), and 21(1)(l) Proposal.

charge, the total cost of the credit to the consumer shall be determined, with the exception of any charges payable by the consumer for non-compliance with any of his or her commitments laid down in the credit agreement.' Charges payable for non-compliance are therefore explicitly exempted from the calculation of the APR. If we read together Art. 3(5) and Art. 30(2), we could conclude that default charges are not part of the TCC (the same conclusion the CJ came to in *Soho Group*).

However, a closer look at the relevant provisions on APR might lead us back to the conclusion that default charges are in fact part of the TCC. Art. 3(7) Proposal says that the APR means the TCC '*expressed as an annual percentage of the total amount of credit, where applicable (emphasis added) including the costs referred to in Article 30(2)*'. 'Where applicable' could mean that these costs referred to in Art. 30(2) should not be considered every time the APR is calculated. Also, the provision says that the TCC determined there is for the 'purposes of calculating' the APR. This might suggest that the TCC in Art. 30(2) is not necessarily the same as it is in Art. 3(5). In other words, on this reading of the provision, the fact that charges for non-compliance are excluded from the APR does not necessarily mean that the same charges are also excluded from the TCC. Again, this significant uncertainty should be addressed.

In relation to default, there is yet more uncertainty in relation to *default interest*. Neither the Proposal nor the CCD, make any references to default *interest* in the context of TCC. Art. 3(5) Proposal, in defining the TCC, refers to '*interest, commissions, taxes and any other kind of fees*', suggesting that it refers to the interest on one hand and to various charges, commissions and fees on the other. This could mean that there is only one kind of interest that is included in the TCC, i.e., the basic (contractual) interest. However, one might read 'interest' as a generic notion that can include both contractual interest and default interest, after all, the TCC makes no express mention of contractual interest either. Moreover, 'interest' as such is not defined in the Proposal at all, instead it refers to the notion of a 'borrowing rate'. The 'borrowing rate' is the '*interest rate expressed as a fixed or variable percentage applied on an annual basis to the amount of credit drawn down*'.[95] Given that based on this definition in the CCD, it has been shown that the borrowing rate normally includes default interest in MS;[96] one could argue that the default interest is already included in the TCC. However, we could also come to the opposite conclusion, that the TCC refers solely to (contractual) 'interest' precisely to signal exclusion of default interest. This conclusion is supported by contextual interpretation that shows us that the drafters were indeed aware of the difference between default interest and (contractual) interest. Under the information provisions, the Proposal refers to 'the interest rate applicable in the case of late payments'[97] while no express reference is made to such interest in the Art. 3(5) definition of the TCC. There is therefore significant uncertainty as to whether default interest is part of the TCC, that should be addressed.

[95] Art. 3(8) Proposal and Art. 3(j) CCD.
[96] Refiner et al. (n 52) 94.
[97] See Arts. 10(3)(m), 11(2)(k) and 21(1)(l) Proposal.

B. The content of APR

In addition to Art. 3(7), according to which the APR is the expression of the TCC as an annual percentage, the proposal also provides for calculation of the APR by a mathematical formula set out in Annex IV. Further rules on calculation are provided in Art. 30(2) Proposal, the main rule being that the APR equates on an annual basis to the present value of all, future or existing, commitments (drawdowns, repayments, and charges) that are part of the contract.[98]

Notwithstanding that the APR is an expression of the TCC, the APR does not seem to strive to be inclusive of all costs. A careful read of Art. 30(2) suggests that ancillary charges are only included in the calculation of the APR if they are payable for non-compliance with the consumer's commitments under the contract, or default (as discussed above); or they are optional. Art. 30(2) directly refers to the exemption of optional bank accounts, provided '*the costs of the account have been clearly and separately identified in the credit agreement*'. However, in practice, other optional services had a similar faith. E.g. the payment protection insurance, optional insurance product that is added to cover missed payments in case of temporary unemployment etc., although caused a lot of consumer detriment, they were not factored into the APR in all MS.[99] In terms of loan extension fees, in the light of the above discussion in the context of TCC, Art. 30(2) would suggest, they are not part of the TCC because they are optional, provided the costs are clearly and separately identified in the contract. However, the CJ in *Soho Group* ruled that they are indeed part of TCC at least under the existing CCD. Recognising the relationship of TCC with APR, CJ said that although loan extension fees are not expressly included in the scope of APR they should be, and the uncertainty at the time when the contract is concluded whether they will be exercised, should be handled via 'assumptions' when calculating the APR.[100]

Assumptions play an important role in calculating the APR. The APR should as a rule only include those costs that are certain and quantifiable at the time of contract conclusion. However, if the definite cost elements or their amounts are not known at that time, the APR will be based on assumptions.[101] The key assumption under Art. 30(3) Proposal, is that the credit agreement is going to be valid for the agreed period and both parties will fulfil their contractual obligations. Importantly also under Art. 30(4), where the contract allows for variations in the '*borrowing rate or variations in certain charges … which make them unquantifiable at the time of calculation*' the APR will be calculated on the assumption that they remain fixed throughout the duration of the contract, at the level they were set at the time when the contract was concluded. Therefore, it does seem plausible, as the CJ have suggested, that loan extension fees could be included in the calculation of the APR provided the relevant assumptions are provided. It could be assumed that the loan is extended at

[98] Art. 30(1) Proposal.
[99] Reifner et al. (n 52) 94-5.
[100] Soho Group (n 5) 47. See also Fejős (n 76).
[101] Guidelines on the application of Directive 2008/48/EC (Consumer Credit Directive) in relation to costs and the Annual Percentage Rate of charge, SWD (2012) 128 final, 27 available at <https://ec.europa.eu/transparency/documents-register/detail?ref=SWD(2012)128&lang=en> accessed 1 March 2022.

least once, or a more precise figure could be assumed using statistical evidence for the type of loan. The same strategy could be applied to include default charges and interest in the calculation of the APR. [102]

However, these assumptions (that the loan will be extended, and as to a precise figure) are not provided for in the list of assumptions in Art. 30 and Annex IV; and Art. 30(5) is clear that the list of assumptions is closed.[103] It is unclear whether this was a deliberate omission, made in with the intention of ruling out the approach taken in *Soho Group*; or whether the approach in the *Soho Group* case was simply overlooked, and might have been followed if it had been fully reflected on. This should be clarified. If the *Soho Group* approach is to be followed, then the list of assumptions should be amended accordingly.

IV. THE SECOND STEP SIDEWAYS: THE UNSETTLED NATURE OF THE CAP

The second problematic aspect of the proposed regime is that neither Art. 31 nor the recitals or the preparatory documents[104] indicate what tools can be used as caps by MS. There is no question that 'caps' mean *substantive* limits on the levels of costs; however, substantive limits can come in many forms, ranging from fixed figures to general principles. While there may be good reason to allow some flexibility, national implementation would be made easier and more effective if it were explicitly signalled which type of caps are permitted, any that are not, or only allowed subject to certain conditions.

A. Fixed caps

One way to cap the rate of interest, the APR or the TCC is to introduce fixed caps. Fixed caps can come in many forms such as a fixed percentage rate, e.g. the maximum annual interest rate in Sweden in 40%; or as an adjusted rate with fixed benchmarks, e.g. the cap is two times the average APR calculated by Bank of Slovakia based on banking sector rates,[105] They may be set by government (ministries), regulatory authorities, or the legislator.[106]

It is not clear that fixed caps are absolutely required, and other options not allowed. Nevertheless, it seems at least that in drafting the Proposal fixed caps were probably mostly in the drafters' minds.[107] Fixed caps are attractive in providing certainty for creditors, consumers, regulators, and courts in their interpretation and application. This may be especially important for consumers as the weaker party with fewer resources, who needs effective proactive regulatory enforcement and for whom court actions are even more burdensome if complicated by uncertainty. Another advantage of fixed caps for creditors

[102] Ibid 17.
[103] Art. 30(5) Proposal, equivalent to Art. 19(5) CCD.
[104] In particular, Commission (n 43); ICF Consulting (n 2).
[105] Commission (n 43) 128
[106] Reifner et al. (n 52) 54.
[107] See Ibid.

and consumers is that this also provides a clear reference point below which creditors can compete.

As long as fixed caps limit the interest, APR or TCC in a direct and manifest way they would probably be compliant with Art. 31. Nevertheless, as there is already 23 MS that set caps on the rate of interest or the APR, the Proposal or the separate Guidance should say expressly that existing or new fixed caps are permitted as long as they focus on the interest rate and/or the TCC and/or the APR. This would help provide clarity for MS and make for more effective implementation. Other caps that do not focus on the interest, the APR or the TCC will not be sufficient, e.g., caps on loan extensions[108] or default interest.[109] Whilst as discussed below these could be part of the APR or the TCC, a freestanding cap on these cost elements does not satisfy the requirements of Art. 31.

B. Laesio enormis and usury

Laesio enormis and usury are common price control mechanisms in continental European legal systems, with a tradition looking back to long before European integration. Can these principles be considered caps under Art. 31 of the Proposal?

Laesio enormis originates from Roman law *laesio ultra dimidium* entitling the seller to rescind the contract and ask for restitution if the purchase price of land did not reach the value of the land (*iustum rei pretium*).[110] Over the centuries the principle evolved providing various measures for a just price,[111] to modern rules now referring to 'unfair advantage' in the parties rights and duties, also extending the scope of the principle to a broader range of contracts and to protecting both parties from paying too much.[112]

In regulating unfair advantage, some countries have fixed limits. In Austria, laesio enormis allows a contracting party to rescind the contract who received less than half of the fair value;[113] fair value being determined by reference to the average market price;[114] unless circumstances exist that void the rule such as when the party knew the true value or accepted the disproportionate performance out of special preference.[115] Other countries abolished fixed limits. In Hungary for instance, the injured party can avoid the contact for 'manifest disproportion' in the parties rights and duties, where he/she did not have an intention to make a free of charge donation or accept the risk of there being a manifest disproportion.[116] In determining manifest disproportion courts primarily compare the disparity with market norms, but also consider the context of the entire contract, its relation with other contracts between the parties, the process of contract conclusion,

[108] As in France, Latvia and Lithuania. ICF Consulting (n 2) 45.
[109] E.g. in Romania. Commission (n 43) 128.
[110] M. Szűcs, 'Pravična cena (iustum pretium) i njena primena tokom istorije' {Just price (iustum pretium) and its application throughout the history} (2006) (120) *Zbornik Matice srpske za društvene nauke* 199.
[111] R. Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (OUP, 1996) 264-267.
[112] A. Grebieniow, 'Remedies for Inequality in Exchange. Comparative Perspectives for the Evolution of the Law in the 21st Century' (2019)(1) *European Review of Private Law* 3.
[113] § 934 of Austrian General Civil Code (ABGB)
[114] Refiner et al. (n 52) 54.
[115] § 935 AGBG
[116] § 6:98 Act V of 2013 on the Hungarian Civil Code.

especially the method of price valuation,[117] and any special interests that would lead the party to agree on a higher than market value price.[118]

MS also tend to have usury laws in place aiming to limit or eliminate (extortionate) interest rates. In addition to disparity in the parties rights and duties, the distinguishing feature of usury is the intention to and intended to abuse the others disadvantaged situation.[119] Due to this usury contracts are usually void, and may also trigger criminal sanctions.[120] In Hungary, usurious contracts are defined by way of a general clause as one contracting party abusing the other party's situation to gain a manifestly disproportionate advantage.[121] There is a subjective element requiring knowledge of the grave material situation of the other party and then taking advantage of this to conclude the contract on the (objectively) usurious terms.[122] However, the combination of subjective-objective elements is not the only way to define usury. The French Consumer Protection Code is a good example of a modern, objective approach taking the APR as the benchmark. The loan is usurious when the APR is, at the time of its granting, more than one third higher than the APR applied by credit institutions in the previous quarter for transactions of the same type involving similar risks (as defined by the administrative authority after consulting the Financial Sector Advisory Committee).[123]

Although aiming to achieve a just price, the traditional rules of usury and laesio enormis may not the best tools to use as a price cap. Both are expressed as open textured general clauses (e.g., 'manifest disproportion'), and albeit that they are often tied to market norm measures, they are clearly vaguer and less certain than fixed caps. Usury often incorporates subjective elements, an extra and potentially problematic hurdles to get over in their enforcement.[124]

The Proposal does not clearly rule out use of such concepts as caps under Art. 31. Indeed, the preparatory documents to the Proposal mention that the proposed regime is likely to maintain the current diversity in MS' approaches in regulating specific credit products.[125] It is possible, in addition to fixed caps some MS will use usury or *laesio enormis* principles and that this would be acceptable. Also, it could be important to provide some flexibility to MS in this regard. Usury and *laesio enormis* are deeply embedded in national tradition, and there may be well established ways in which they are used to regulate credit; ways that it

[117] E.g., Directional decisions of the Hungarian Supreme Court: EBH 2002. 643, EBH 2003. 870
[118] E.g. the price is reached at auction. Hungarian Court Decision BH 2002.146.
[119] See e.g. § 879 ABGB, § 1935 of the Belgian Civil Code (BW), Art. 1907 of Luxembourg Civil Code
[120] See e.g. Reifner et al. (n 52) 45.
[121] § 6:97 of the Hungarian Civil Code
[122] E. Vizkeleti 'Az uzsora megállapításának gyakorlati problémái' {Practical aspects of finding usury'} (2012) *Jogi Fórum* available at <http://www.jogiforum.hu/files/publikaciok/vizkeleti_edit__az_uzsora_megallapitasanak_gyakorlati_problemai[jogi_forum].pdf> accessed 1 March 2022.
[123] French Consumer Protection Code, Art. L. 314-6.
[124] K. Gellén '*A másik fél helyzetének kihasználásával kötött szerződések a Magánjogi Törvényjavaslattól napjainkig*' {Contract concluded with the abuse of the others' situation from the Civil Law Codification proposal until today}, *XV. Polgári Jogot Oktatók Országos Találkozójának Konferencia-kötete* (Novotni, 2010) 6.
[125] ICF Consulting (n 2) 54.

would be disruptive to refuse to recognise. Indeed, there seems to be some evidence that traditional principles such as *laesio enormis* are preferred by stakeholders rather than fixed rate ceilings.[126]

The problem again is the lack of clarity. Ideally the regime should state expressly that these principles can act as caps subject to conditions as to how they operate in national laws. As established by the case-law of the CJ, existing general principles are sufficient to implement EU directives without requiring additional legislative action, provided, a principle can be fully applied and is sufficiently clear and precise to be relied upon by individuals.[127] Therefore, first it would need to be insisted that these principles must cap the interest rate and/or TCC and/or the APR. Second, it might be required that the national version of the principle must be based on objective criteria, and not be too open textured and uncertain, taking too broad a range of criteria into account. On this basis, for example, the Hungarian usury principle would be disqualified for its subjective element; while the Hungarian *laesio enormis* principle might take into account too many factors, so being too unpredictable. In contrast, usury in France can be characterised as a fixed cap[128] and could be the sort of tool the legislation should recognise explicitly as being complaint with Art. 31. Third, it might plausibly be required that in order to qualify under Article 31, the principle should be backed by *ex ante* administrative enforcement instead of or along with *ex post* judicial enforcement; this making for more effective enforcement. [129]

C. Contractual fairness

A further way of imposing a substantive cap is under Art. 3(1) of Directive 1993/13/EC on Unfair Contracts Terms (UCTD),[130] which provides that a term is unfair if contrary to good faith it causes significant imbalance in the parties' rights and obligations.[131]

Although the UCTD applies to all contracts, including credit contracts,[132] the Proposal does not directly deal with the relationship to the UCTD in relation to the cap. It does however say in Recs. 30 and 53 that the creditor's obligation to comply with information provisions (including on the interest rate, TCC and APR) are without prejudice to the UCTD. This probably means that, subject to the UCTD's own conditions and limitations, its test of fairness can apply to terms related to the interest, TCC and APR. This interpretation would align with the statement in the Proposal that it is consistent with the UCTD,[133] and seems

[126] Refiner et al. (n 52) 132.
[127] C-303/20 Ultimo Portfolio Investment, ECLI:EU:C:2021:479, C-475/08 Commission v Belgium, EU:C:2009:751, 41; C-29/84 Commission v Germany ECLI:EU:C:1985:229, 23; C-456/03 Commission v Italy ECLI:EU:C:2005:388, 51.
[128] Ibid, 38.
[129] Y. M. Atamer, P. Pichonnaz, 'Control of Price Related terms in Standard Form Contracts: General Report' 56-58 in Y. M Atamer, P. Pichonnaz (eds) *Control of Price Related Terms in Standard Form Contracts* (Springer, 2020).
[130] Directive 93/13/EEC on unfair terms in consumer contracts OJ L 95, 21.4.1993, 29–34.
[131] Art. 3(1) UCTD.
[132] Art. 2 CCD.
[133] Proposal, Part 1.

to be confirmed by the CJ.[134] Naturally, just because the UCTD test of fairness can apply does not mean the Proposal intends it to qualify as a cap for the purposes of Art. 31, and the fact that it is not mentioned explicitly in relation to Art. 31 could suggest that it is not intended to so qualify. Again, this is uncertain.

Indeed, for the reasons now to be set out, if the UCTD test of fairness were to be allowed to be used as the Art. 31 cap this would be likely to be ineffective and to cause ongoing uncertainty. First, Art. 4(2) provides an important exemption from the test of fairness, making the test appliable to the 'main subject matter' and 'the adequacy of the price paid in exchange for the goods or services', subject to these being transparent. The contours of these main subject matter and price exemptions have been frequently explored,[135] this work highlighting the doubts as to exactly which charges in consumer credit contracts count as the price.[136] There is little doubt that the Art. 4(2) exemption covers charges for the main service provided, that is, the payment of the interest. It is therefore difficult to use the fairness to cap the interest rate, without MS removing the exemption or at least removing it specifically for this purpose, which they can do given the minimum nature of the UCTD. [137]

The exemption does not cover terms such as price variation clauses and clauses relating to the method of price calculation, where the issue is not the amount of the charge, but its variability or how it is calculated.[138] Neither does it cover default charges.[139] However, where ancillary charges (even those looking very much like default charges, e.g. charges for exceeding agreed overdrafts) are presented formally as being services, they have been held to be covered by the exemption.[140] Also the Spanish Supreme Court contemplated that the rounding up clause, a term that the rate of interest due by the consumer will be rounded up to the nearest quarter of a percent higher, could be considered under the Art. 4(2) exemption.[141] It is clear then that applying the test of fairness to the various components of the TCC would be very problematic given that some such components would be covered by the Art. 4(2) exemption, others not, and in the case of others there would be uncertainty. There is also very significant uncertainty as to whether the APR is covered by the Art. 4(2) exemption: one might argue that such an annual percentage expression of the TCC is not a charge for services as such, but on the other hand it could be contended that

[134] See e.g., Matei (n 70) 47; C-331/18 Pohotovost', ECLI:EU:C:2019:665; 71 ; C-303/20; Ultimo Portfolio Investment (n 127) 42.
[135] See e.g. Atamer, Pichonnaz (n 20).
[136] A. Fejős, European, Hungarian and Serbian models of fairness in consumer contracts and their application to consumer credit, PhD Dissertation (University of Szeged, 2014) 141-151 available at https://doktori.hu/index.php?menuid=193&lang=EN&vid=12308
[137] Only five MS did not implement Art. 4(2). Commission notice — Guidance on the interpretation and application of Council Directive 93/13/EEC on unfair terms in consumer contracts, OJ C 323, 27.9.2019, 4–92, Annex II.
[138] Annex 2(b) UCTD. See also C-472/10 Invitel, EU:C:2012:242, 23.
[139] Annex 1 (e) UCTD.
[140] C-26/13 Kásler ECLI:EU:C:2014:282, 57-58; Office of Fair Trading v Abbey National Plc [2009] UKSC 6
[141] C-484/08 Caja de Ahorros y Monte de Piedad de Madrid, ECLI:EU:C:2010:309, 14.

there is a sufficient link to the services for which the TCC charges are made for the APR to be covered by Art. 4(2).[142]

Finally, Art. 4(2) the exemption does not apply where the price in question is not sufficiently transparent, meaning that the consumer should be able to understand it's full economic consequences;[143] yet there can be uncertainty as to when this is and is not satisfied with the huge range of complex charges in credit contracts.[144]

A further problem is that even if charges are not within the Art. 4(2) exemption, and the fairness test in Art. 3(2) UCTD applies; for the specific purposes of setting caps, this test is arguably too open textured and uncertain, taking too broad a range of criteria into account. It contains not only the open textured good faith, imbalance and detriment criteria; but it is also connected to Art. 4(1) under which in determining the fairness of the terms regard should be given to the 'nature of the …. services for which the contract was concluded and …. all the circumstances attending the conclusion of the contract and … all the other terms of the contract or of another contract on which it is dependent'.

Therefore, for the reasons above, further drafts, or at least Guidance, should indicate expressly that the UCTD fairness test does not qualify as a cap under Art. 31 of the Proposal. Naturally, the UCTD test will continue to apply to terms not covered by the Art. 4(2) UCTD exemption. In this regard thought needs to be given to the precise relationship this should have with the Art. 31 cap in cases where there is overlap.

V. FROM FORMAL TO SUBSTANTIVE HARMONISATION

The Proposal supports the current full harmonisation trend in EU consumer law.[145] It follows in the footsteps of the current CCD, which was one of the early full harmonization consumer protection instruments. This means that MS should not maintain or introduce national provisions providing greater protection than that provided for in the CCD.[146] This approach was thought necessary to remove the existing regulatory differences in MS, thus creating a well-functioning internal market in consumer credit.[147]

However, the degree of harmonisation should be considered in relation to the scope of harmonisation.[148] We have seen above that the CJ has already ruled that Art. 3(g) CCD is

[142] See C-331/18 Pohotovost' (n 134); C-236/12 Volksbank România, ECLI:EU:C:2014:241.
[143] Kásler (n 140) 75.
[144] See e.g., C-290/19 Home Credit Slovakia EU:C:2019:1130; Joined Cases C-84/19, C-222/19 and C-252/19 Profi Credit Polska EU:C:2020:631; Mikrokasa (n 5); and C-229/20 K () and services acccessoires) not yet reported.
[145] See e.g. Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property, OJ L 60, 28.2.2014, 34-85; Directive (EU) 2015/2366 on payment services in the internal market, OJ L 337, 23.12.2015, p. 35–127; Directive 2011/83/EU on consumer rights OJ L 304, 22.11.2011, 64–88, Directive (EU) 2019/770 on certain aspects concerning contracts for the supply of digital content and digital service, OJ L 136, 22.5.2019, 1–27.
[146] Art. 42(1) Proposal.
[147] Rec. 13 Proposal
[148] Lexitor (n 70) 33: see Mak (n 30) for problems in determining the 'harmonised field.'

not a full harmonisation provision, moreover, substantive product regulation in form of cost caps is not harmonised at all and this enabled MS to maintain or introduce cost caps.[149] It is also true that the Proposal exempts some provisions from the full harmonization approach, but Art. 31 does not seem to be and should not be one of these exemptions.[150] If we were to maximise the degree of commonality in approach, in the belief that this is necessary to protect consumers and improve the operation of the internal market, Art. 31 has to follow the full harmonisation approach. MS can only cap the benchmarks stipulated by Art. 31, in the manner intended by Art. 31.

However, even it is clear Art. 31 intends to achieve full harmonisation, there may be different 'modes' of full harmonisation. It is outside the scope of this paper to revisit in depth the broader debate as to whether full harmonization generally is a needed, whether it takes too much autonomy from MS, prevents MS from pursuing social justice goals etc.[151] The focus here, rather, is on what makes for good full harmonization, if full harmonization is going to be used. The starting point is that the numerous uncertainties set out throughout this paper would produce varying understandings and approaches in MS, undermining the effectiveness of Art. 31 as a harmonising measure that protects consumers to a high level and develops the internal market.[152] Of course, the effect of full harmonisation on developing the internal market is debated.[153] However, even if the impact on internal market building is marginal then this is undermined by uncertainties that may cause confusion and diffusion. Indeed, even if full harmonization has no impact at all on the internal market, it is arguably better to minimise such problems so that consumers are provided with clear strong protection and the time and resources of legislators, regulators, courts and businesses are not wasted with arguments over what charges should be capped and what tools should be used to cap them. With this in mind, it is submitted that it helps to re-conceptualise harmonization: to think of 'formal' harmonization, which leaves significant uncertainty; and 'substantive' harmonization, which seeks to minimise uncertainty.

The idea of formal and substantive harmonization is new to consumer law literature. It is developed here, inspired by comparable distinctions already made in consumer law and beyond. A distinction has been made between formal and substantive transparency. Formal transparency includes provisions enabling consumers to access the contract terms and read them for basic understanding. Substantive transparency is more interventionist, including obligations on the business to provide information in a way that enables consumers to understand the full meaning of these provisions.[154] Therefore, formal transparency is process oriented, focusing on the way in which information is

[149] Mikrokasa (n 5) 48; Soho Group (n 5); see also Lexitor (n 70) 37; SC Volksbank România (n 72) 44.
[150] Art. 42(2) Proposal.
[151] See (n 4).
[152] Explanatory Memorandum, Reasons for and objectives of the proposal, Proposal.
[153] See (n 30).
[154] Luzak, Junuzović (n 23); see also F. B. d'Usseaux, Formal and substantive aspects of the transparency principle in European Private Law, (1998) Consumer Law Journal 320; *Johanna Waelkens*, Article 5 Unfair Terms Directive 93/13/EEC: Transparency and Interpretation in Consumer Contracts, 47 in I. Samoy, M.B.M. Loos (eds.) *Information and Notification Duties* (Intersentia, 2015).

communicated, substantive transparency is result oriented, aiming to achieve understanding of the terms, a genuine enrichment of informed decision making communicated. The idea of formal and substantive harmonization can also be linked to procedural and substantive fairness, well established concepts in unfair terms regulation. While procedural fairness focuses on the process of contract conclusion e.g. how transparent the terms are; substantive fairness is concerned with the content of the terms, whether they achieve the right balance in the parties rights and duties under the contract.[155] These ideas of procedural/formal and substantive fairness are also used in consumer alternative dispute resolution literature.[156] Clearly form versus substance distinctions are common in law more generally and in other disciplines.[157] By analogy, the idea here is that substantive harmonization is result oriented. Rather than simply harmonizing rules formally, on their 'surface'; it strives to achieve harmonization in the substance of the rules; here this means in relation to the precise constituent elements of the TCC and the APR and in relation to the tools that can be used as price caps.

We can therefore say that the proposed Art. 31 falls into the 'formal' harmonization category, as it leaves so much uncertainty and is likely to cause significant substantive disparity in the approaches taken to 'what to cap' and 'how to cap'. However, this paper has suggested how it can be more of a substantive harmonization measure: by more fully unpacking precisely what charges are in the TCC and APR; and what tools can be used to cap, subject to what conditions. This would reduce uncertainty and be likely to lead to closer assimilation in substance between national approaches. This in turn makes for a fairer, more level competitive playing field for businesses, and may improve consumer confidence in cross border shopping. The substantive harmonization proposed here does not as such lead to unification of the costs of credit. It does not determine whether caps are placed on the rate of interest, APR or TCC the choice that remains for natural rule-makers; and neither does it determine the maximum amount of these caps. The proposed substantive harmonization would however provide a greater degree of unification on the constituent elements of the cost cap, and on the appropriate tools for capping.

VI. CONCLUSION

This paper has argued that the Proposal takes a very significant further step away from dependence on the information paradigm in EU consumer credit law, with the requiremnt of substantive product intervention in the form of caps on the interest rate and/or TCC and/or APR. This is important in achieving the strong consumer protection goals of the Proposal: recognisising the serious limits of information rules in producing genuine informed consent and the need for product regulation.

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[155] C. Willett, 'General Clauses and Competing Ethics of European Consumer Law in the UK' (2012) 71 *The Cambridge Law Journal* 412; A. Fejős 'Fairness of Contract Terms in European and Serbian Law' in T. Bourgoignie, T. Jovanić (eds.) *Strengthening Consumer Protection in Serbia*, (Belgrade Law Faculty, 2013).

[156] See e.g. U. Amajuoyi, A. Fejős 'Mind the Consumer Protection Gap: the UK Financial Ombudsman Service, Fairness and Reasonableness, and the Law' (forthcoming); A. Fejős, C. Willett 'Consumer Access to Justice: the role of the ADR Directive and the Member States' (2016) 24 (1) *European Review of Private Law* 31.

[157] E.g. in accounting (n 31).

However, the paper has also shown that there are two key areas of uncertainty or 'sideways steps'. The first is as to the charges covered by cap: particularly whether the TCC and APR include loan extension fees, default interest and default fees. It is shown that these uncertainties need to be clarified. Second, the provision is unclear on exactly what legal tools can be used as a 'cap'. It is argued that it should be clarified that fixed caps are certainly acceptable; that national laesio enormis and usury principles may be used but only if they cover the interest rate and/or TCC and or the APR, are based on objective criteria, are not too open textured and uncertain, and can be easily enforced. It should be provided that the UCTD test of fairness is unsuitable due to the uncertainty as to the price exemption and the vagueness of the fairness test itself.

Further it has been argued that without clarification, these uncertainties will undermine the effectiveness of the cap as a harmonizing measure that provides a high level of protection and develops the internal market. Two new harmonization concepts are developed to explain the alternative approaches: 'formal' harmonization, currently in the Proposal, leaving too much room for different interpretations and destabilising the regime; and 'substantive' harmonization which, as suggested here, much more fully explains the requirements, thereby enhancing certainty, the degree of harmonization, fairness, and consumer confidence.

It has been suggested that the uncertainties identified in this paper should be addressed either in the Proposal itself during the current legislative process or in a separate Guidance document issued by the Commission. Whilst developing comprehensive Guidance on EU level might not be easy,[158] the Commission is much better placed in terms of resources to conduct the relevant research than MS. In addition to laying down general principles further elaborating on the objectives of the intervention in caps context, the Commission should probably take a product-based approach,[159] to create a taxonomy of most used loan categories throughout the EU and to create a list of possible cap-models that MS could follow. This approach would also enable the Commission to further lead MS in achieving the goals of this landmark intervention.

Developing the internal market and achieving a high level of consumer are objectives of all EU consumer law instruments. If achievement of these objectives is to be meaningful and effective, the substantive harmonization suggested here should be taken seriously, in this credit capping context and wherever else the complexity and scope for confusion require it. Key to achieving the set objectives is to have a very clear focus on the outcomes the rules seek to achieve,[160] and to reflect carefully on legal and technical complexities that must be grappled with to achieve these effectively. The Commission and the other actors in the EU law-making process should set out what outcomes a well-functioning internal market in consumer credit should be achieving; and then proceed to drive the market, including the

[158] ICF Consulting (n 2), 45.
[159] *Cf* Ibid.
[160] Financial Conduct Authority, The Woolard Review - A review of change and innovation in the unsecured credit market (FCA, 2021) 57 available at <https://www.fca.org.uk/news/press-releases/fca-publishes-woolard-review-unsecured-credit-market> accessed 1 March 2022.

preferred cap-design, in that direction.[161] Consequently, in providing greater clarity on what is covered by TCC and APR, and in deciding exactly what sorts of tools can be used to cap the various elements, and under what conditions, it may be important to ask questions such as: what is the intended consumer welfare outcome? For instance, is the aim to achieve minimum security that all loans are subject to at least some form of cap throughout the EU, and/or to decrease the cost of credit and/or to increase the comparability of credit products? Establishing the concrete aims of the product intervention, the sort of sub-objectives within the broadly set general objectives of EU consumer policy, may lead to more concrete choices about what sorts of charges should be included under the different cap heads, and what tools should be used. This has been lacking to a degree so far. The particularities of the step from information rules to substantive intervention has not been developed carefully enough. The interest rate, TCC and APR concepts were substantially copied out from the current CCD without considering their content and the effect they would produce in relation to the new cap requirements.

Without a doubt, the information provisions are much more developed than cost related provisions. This is probably partly because not enough thought has gone into designing the cost related aspects of the Proposal. It may also be because of over-cautiousness based on the sensitivity of substantive capping compared to less interventionist information rules. Either way, the suggestions provided in this paper would not add to any 'controversy' there may be in introducing product intervention; but rather aim to improve clarity and effectiveness in achieving the high level of consumer protection and the internal market goals.

[161] Ibid.