

THE TRANSPARENCY OF CONSUMER CREDIT AGREEMENTS: A COMPARATIVE ANALYSIS OF RUSSIAN AND EUROPEAN LAW

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Abstract

The article reveals features of the implementation of principle of transparency in consumer credit agreements based on the legislation of the Russian Federation and the European Union. A comparative analysis of the main aspects of the implementation of the principle of transparency allows to observe different approaches in Russian and European banking practice. Based on the analysis carried out, some recommendations aimed at improving the Russian practice of ensuring the principle of transparency in credit agreements for consumers are formulated.

Key words: principle of transparency, consumer, credit agreement, consumer lending, banking institutions, consumer protection.

Introduction

Credits are extremely important for the economic development of any country; a consumer credit is not an exception. Credit allows consumers to pay for goods and services that they are unable or unwilling to pay for in full at one time. Moreover, a well-functioning consumer credit market benefits consumers, manufacturers and sellers of goods and services, and stimulates economic growth.

According to numerous studies, Russian society is mired in debt from loans taken out which puts the economy at risk. Especially, this issue becomes more sensitive during the crisis from the recently emerged coronavirus pandemic. Therefore, consumer lending is extremely relevant where sufficient guarantees of protection of individuals should be provided.

The purpose of the article is to examine main aspects of the implementation of the principle of transparency in credit agreements for consumers in the Russian practice and at the European Union (hereinafter – “EU”) level. Based on the analysis of Directive 2008/48/EC on credit agreement for consumers (hereinafter - the “CCD”)¹, some recommendations are formulated aimed at improving the Russian practice of ensuring the principle of transparency in credit contracts. To achieve the mentioned purpose, it is necessary to compare guarantees entrenched in the CCD and safeguards provided by the Russian legislator in the field of consumer lending from the point of view of transparency of a credit agreement.

It is true to say that the CCD is a really well-coordinated mechanism for building relations between a consumer and a bank or other credit organization. Among all aspects, in this work, I

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¹ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC OJ L 133, 22.5.2008, p. 66–92.

would like to focus on the implementation of the principle of transparency in the consumer lending agreement. The issue of ensuring the principle of transparency in credit contracts will always remain relevant. As far as transparency is a starting point for the formation of public confidence in banking institutions and, as a result, contributes to the effective functioning of any banking system².

Transparency is understood primarily as a concept that has to do with the need for contractual clauses to be clear, easy to understand (formal transparency)³. Therefore, a consumer when contracting with a bank can demand that clauses of his/her contract be transparent, which from a formal point of view means that they must be clear, understandable and do not refer to other (obscured) texts. Also what is referred to as substantive transparency is also required, that is, that not only the clauses of the contract must be clear, but that the consumer must understand the legal, economic and other consequences of the terms⁴.

Transparency in practice is understood as a principle with legal value, because a consumer can ask to have declared null and void any clauses of any contract, if possible consequences of it were not clear and transparent, at the time of signing⁵.

1. Principle of transparency at the EU level

Let us start with evaluating the safeguards in terms of the principle of transparency at the EU level. Up to date, the CCD, amended from time to time, has been regulating consumer lending (with the exception of certain types of loans, i.e., a mortgage). The CCD is main part of the legal framework tackling consumer protection and the development of the internal market.

The EU adheres to a concept of a higher level of protection primarily expressed in consumers' increased information capacity related to credit agreements, as well as a responsible consumer lending practice across the EU⁶.

Two key objectives can be derived from the CCD. First of all, it aims to strengthen consumer protection and boost consumer confidence. Additionally, it is oriented to foster the development of a well-functioning internal market where a free movement of credits takes place under optimally balanced conditions for those who offer credit and those who require it⁷.

The CCD sheds light on relations between creditors and consumers. To enable consumers to take an informed decision, creditors must provide them with standard information in the advertising (Article 4) and in the pre-contractual stage (Articles 5-7) by means of the Standard European Consumer Credit Information form. This standardized form is designed to show key details, such as the type and conditions of credit, the total amount including costs, the annual percentage rate, the number and frequency of payments, and other important legal aspects, such as the consumers' right to withdraw from a credit agreement and to an early repayment of their

² ЕРЖАНОВА, Меруерт: Принцип прозрачности в банковских договорах. Вестник Института законодательства и правовой информации. 2020/2 (60) 240-247. [ERZHANOVA, Meruert: Principle of transparency in banking contracts. Bulletin of the institute of legislation and legal information 2020/2 (60) 240-247.]

³ LUZAK, Joasia – JUNUZOVIC Mia: Blurred Lines: Between Formal and Substantive Transparency in Consumer Credit Contracts. Journal of European Consumer and Market Law (EuCML).2019 / 8(3), 97-107.

⁴ Ibid.

⁵ BAOS, Carlos: Transparency and its legal importance in the claims of consumers and users. 2018. Available online on: <https://www.white-baos.com/en/transparency-and-its-legal-importance-in-the-claims-of-consumers-and-users-know-your-rights/> (accessed: 2021.08.29)

⁶ Cambridge Yearbook of European Legal Studies, Volume 16. 2014. p. 223.

⁷ Revision of Directive 2008/48/EC on credit agreements for consumers. 2021.

credit. Before the conclusion of a credit agreement, the creditor must assess the consumer's creditworthiness (Article 8). This obligation is aimed at fostering responsible lending. The idea behind the concept of responsible lending is that creditors should not act exclusively in their own interests but that they should also take into account the consumers' interests and needs throughout the relationship in order to prevent consumer detriment. This refers to both pre-contractual and post-contractual stages of relationships between creditors/intermediaries and borrowers, and covers the whole life cycle of credit products, from their inception through marketing and until the borrower has repaid the loan⁸.

Afterwards, the contract needs to specify some key information concerning the execution of the credit (Article 10). The consumer can withdraw from the credit agreement within 14 days of concluding it, without giving any reason (Article 14(1)). Consumers are entitled at any time to repay their credit partially or fully, and in such cases, they are entitled to a reduction in the total cost of the credit (Article 16(1)). Creditors are entitled to fair and objectively justified compensation under certain conditions (Article 16(2)). This protection enshrined in CCD strikes a new balance in the creditor-consumer relationship is expected to foster the establishment of a trans-border credit market.

Summing up, looking at the provisions of the CCD, the principle of transparency is observed as a general concept that the creditor, the credit intermediary and the provider of credit services act honestly, fairly, transparently and professionally and always take account of the rights and interests of the consumers. Similarly, the principle of transparency is seen at certain stages of the consumer credit agreement as far as the CCD specifies the information that needs to be mentioned in advertising, the information to be provided to the consumer prior to the conclusion of the credit agreement, the information to be included in the credit agreement, the information to be provided during the contractual relationship between the creditor and the consumer, and specific rights of consumers, etc.

In addition, contribution of Organisation for Economic Co-operation and Development (hereinafter – “OECD”) to the development of relations in the field of consumer lending should be considered as well. In 1997, the OECD adopted its Recommendation on consumer protection in the field of consumer credit, in which it insisted on the need for pre-contractual information. In the same vein, it adopted its G20 high-level principles on financial consumer protection in 2011. These 10 principles are similarly reflected in the EU legislation. Section 4 of G20 high-level principles on financial consumer protection also refers to the principle of transparency that information must be disclosed and presented to the consumer at all stages of the conclusion of a credit agreement (including, pre-contractual stage) in an honest, accessible and direct way.⁹

As known, the Court of Justice of the European Union (hereinafter – “CJEU” or the “Court”) plays a crucial role in the interpretation of EU legislation. In this regard, CJEU has provided interpretation on some of the CCD provisions. For instance, in relation to the scope and form of pre-contractual information, the Court concluded that the burden of proving the non-performance of the pre contractual information obligations laid down in Articles 5 and 8 should not lie with the consumer (CA Consumer Finance SA v Bakkaus case¹⁰). The Court clarified some aspects of the creditworthiness assessment. In 2014, in CL le Crédit Lyonnais SA¹¹, CJEU noted that creditworthiness assessments are “intended to protect consumers against the risks of over-indebtedness and bankruptcy”.

⁸ Ibid.

⁹ G20 high-level principles on financial consumer protection. 2011.

¹⁰ C-449/13. CA Consumer Finance SA v Ingrid Bakkaus and Others. CJEU. №. 184, 2014.

¹¹ C-565/12. Le Crédit Lyonnais SA v Fesih Kalhan. CJEU. №. 39, 2014.

Despite the fact that at the EU level, truly high guarantees of consumer protection when concluding credit agreements are ensured, economic and technical development is moving on. The legislator tries to keep up with this development and adapt legislation to new realities. The recently published Proposal for a Directive of the European Parliament and of the Council on consumer credits only proves the aforementioned¹². The European Consumer Organization highlights “since the introduction of the CCD more than 10 years ago, important developments have taken place in Europe. First, a major financial and economic crisis resulted in high unemployment rates and lower household income in many Member States. Second, for several years the EU has experienced historically low interest rates, which gives a further incentive to consumers to borrow for consumption. Third, digitalization has led to widespread online distribution of credit as well as the emergence of new business models such as peer-to-peer lending”¹³. Actually, the third noted reason for the new Proposal is the most relevant¹⁴. Since the adoption of the CCD, digitalization has fundamentally changed the decision-making process and the habits of consumers in general who now want an easier and faster loan process and often do it online. This invariably affects the lending sector as a whole which is gradually becoming digital. New offers have appeared, such as short-term high-cost credit. Digitalization has also led to the emergence of new ways of disclosing information digitally and assessing the creditworthiness of consumers using automated decision-making systems.

In general, in the Proposal, the idea of strengthening consumer protection in the field of consumer lending is preserved and remains consistent with the EU legislation (for example, with recently adopted GDPR), only continues to improve in order to meet the realities of modern world. In the light of digitalization, the EU legislator adheres, throughout the entire text of the Proposal, to the need to specify transparency as one of core principles of future Directive. Such governing with a focus on proper consumer protection increases consumer confidence and encourages unhindered growth of cross-border activities¹⁵.

2. Russian legislation on consumer lending and the principle of transparency

Next, it is necessary to analyze the Russian legislation on consumer lending in context of the principle of transparency. Initially, it should be noted that the principle of transparency as such is not recognized either in literature or in law among the principles of lending¹⁶. Only some sources single out this principle as secondary or additional.

With the rapid development of consumer lending in the Russian Federation, the question of reforming legislation in this area raised. Therefore, since 2014, the consumer credit agreement has been regulated by a separate federal act №353-FZ on consumer credit¹⁷

¹² Revision of Directive 2008/48/EC on credit agreements for consumers. 2021.

¹³ Review of the Consumer Credit Directive, BEUC position. 2019.

¹⁴ Report from the Commission to the European Parliament and the Council on the implementation of Directive 2008/48/EC on credit agreements for consumers. 2014.

¹⁵ Proposal for a Directive of the European Parliament and of the Council on consumer credits. 2021.

¹⁶ ХАЧАТУРОВА И. Потребительский кредит и его социальная значимость. [HACHATUROVA, I.: Consumer credit lending.] Available online on: https://kubsu.ru/sites/default/files/users/18942/portfolio/hachaturova_i_potrebitel'skiy_kredit_i_ego_socialnaya_znachimost_v_rynochnoy_ekonomike.pdf. (accessed: 2021.09.07). See also: ПЕТРОСЯН, Сергей: Потребительское кредитование. [PETROSYAN, Sergei: Consumer lending.] Available online on: https://elib.utmn.ru/jspui/bitstream/ru-tsu/11627/1/Petrosyan_VKR.pdf (accessed: 2021.09.07).

¹⁷ Federal Law "On Consumer Credit (Loan)" dated 21.12.2013 N 353-FZ. Федеральный закон "О потребительском кредите (займе)" от 21.12.2013 N 353-ФЗ

(hereinafter – “Consumer Credit Law” or “Act №353-FZ”), as well as law on consumer protection¹⁸.

Consumer Credit Law has covered many gaps related to consumer credit agreements: the procedure for calculating the full cost of the loan is defined; the maximum size of the penalty is limited; detailed requirements for the content and execution of consumer credit (loan) contracts are established.

Likewise, Act №353-FZ divides the conditions that should be contained in the loan agreement into general and individual. The differences between them are that the general conditions are set by a creditor unilaterally for a purpose of repeated application. Individual conditions, on the contrary, are specified in each contract separately and apply only in the relationship between a lender and a specific borrower. According to Consumer Credit Law, the individual terms of credit agreement, in particular, include the amount of the loan, its repayment period, interest rate and other parameters. It is worth noting that the general conditions are an important part of the contract as well. However, in practice, they are usually posted on credit organizations’ website, that is, a consumer does not see them when signing a contract.

Equally important here is the fact that a right of a borrower to refuse (fully or partially) to receive a credit and its early repayment without prior notice to a lender within 14 days without explanation, with the payment of interest for the actual term of use of money, is legally fixed.¹⁹

If, in connection with a consumer credit, additional services are offered to a borrower for a fee (for example, risk insurance under the contract), a written consent of a consumer is obligatory in this context. A lender must provide a borrower with an opportunity to refuse an additional service. All payments that a borrower is obliged to pay must be specified in the individual terms of a contract.

Under the threat of sanctions, credit organizations try to comply with the established legal requirements. However, in fact, not all lenders faithfully comply with the procedure for attracting potential borrowers and concluding a consumer loan agreement with them. For example, as noted above, insurance is allowed only with a written consent of a borrower to conclude such additional contract. At the same time, it frequently happens when a client, while concluding a consumer loan agreement, signs a document expressing his consent to conclude an insurance contract as well. Although, in fact, a consumer does not have this intention. Clearly, there is an imposition of insurance in the form of persuasion of a client who, due to legal and financial illiteracy, lack of time or other reasons, is forced to agree to such conditions, being confident that otherwise he/she may not receive the necessary funds.

A consumer can also hear from an employee of a credit institution information that after the conclusion of credit agreement, he/she can independently terminate the insurance contract by contacting the insurer and get the insurance premium back. At the same time, consumers should know that in case of early refusal from the insurance contract, the paid premium to the insurer is not subject to refund, unless otherwise stipulated by the terms of the contract. Nevertheless, analyzing the legislation, it can be seen that this provision in relation to the consumer credit agreement is applicable only in a situation where a borrower has used a right to early repayment, provided that it was made within 5 working days. Thus, the lender initially gives unreliable and incomplete information, because in case of refusal of insurance from side of the borrower, (if this type of credit security is mandatory under a consumer loan agreement)

¹⁸ Law of the Russian Federation of 07.02.1992 N 2300-1 "On Consumer protection". Закон РФ от 07.02.1992 N 2300-1 "О защите прав потребителей"

¹⁹ Art.11, Federal Law "On Consumer Credit (Loan)" dated 21.12.2013 N 353-FZ.

the lender has the right to increase the interest rate on the credit or demand early termination of the consumer credit agreement with all further consequences²⁰.

It is noteworthy that according to Article 10 of the Law of the Russian Federation on consumer protection, a creditor's obligation to provide consumers with necessary and reliable information about goods (works, services) in a timely manner, ensuring a possibility of their correct choice. This obligation can be interpreted as a component of the principle of transparency in the conclusion of any contract, including consumer lending. In case of violation of this obligation, (that is, if the consumer did not have sufficient open information about the service, or was misled about any parameters) the contract may be declared invalid²¹. However, the Russian case law shows that chances of proving that a consumer has been misled or infringed on his choice are minimal if there is his signature on the disputed documents (for example, documents related to additional services to credit agreement). Although, in fact, as discussed above, it is quite common that the presence of a consumer's signature on documents does not always mean his full knowledge of all conditions and understanding of all consequences of the credit taken. Thus, this is a rather sad practice showing the dishonesty of some banking organizations and non-compliance with the principle of transparency when concluding a consumer credit agreement.

In addition, it is necessary to take into account that the conclusion of credit agreements in Russia often occurs directly at the time of a client's request to the banking organization, that is, a consumer signs a credit agreement on the same day. In addition, in modern conditions with the increasing digitalization of the economy, a credit agreement can be concluded online without visiting the office of a credit institution. Such a simplified approach to the procedure for concluding a bank agreement significantly increases the risks of subsequent overdue debts and consumer debt, since it contains risks of including such conditions in the credit agreement that may infringe on borrowers' rights and limit means of subsequent protection of their rights. In this regard, the question arises of choosing a rational form of submitting mandatory and important information. It is also important to keep in mind that providing a stream of various information (which is often superfluous for a service that a client currently needs) can mislead him no less effectively than the absence of necessary information in credit agreement.

As it could be seen from the analysis of the Russian legislation on consumer credit, the issues of transparency of credit contracts are insufficiently regulated. Summarizing the above, the following kinds of unfair practices of banks and other credit organizations that arise due to the lack of a properly formalized principle of transparency can be emphasized²²:

- providing customers with information that may directly or indirectly mislead them, including through concealment and ambiguity of description of credit conditions;
- failure to provide or late submission of information that is necessary for a client to make a deliberate decision on a credit agreement;
- inclusion in credit agreements of such conditions that restrict freedom of choice of clients;
- presentation of significant information in a much smaller font which may well lead to a client ignoring this condition despite of its importance;

²⁰ ЧЕРНЯКОВА, Светлана: Правовое регулирование отдельных аспектов заключения и исполнения договора потребительского кредита (займа) в России. Сервис в России и за рубежом. 2017 / 6 (76). 168-175. [CHERNYAKOVA, Svetlana: Legal regulation of certain aspects of the conclusion and execution of a consumer loan agreement in Russia. *Service in Russia and abroad*. 2017/6 (76).168-175.]

²¹ Art.16, Law of the Russian Federation of 07.02.1992 N 2300-1 "On Consumer protection".

²² ERZHANOVA 2020 op. cit.

- providing customers with related products (credit cards, SMS notification, etc.) by imposing these products without proper explanation of the conditions for them;
- abuse of advertising by using other information about the terms of the loan than the actual amount of interest (annual interest rate),

Thus, since 2014, the legislation in the field of consumer lending has been improved and some legal gaps in this sphere have been eliminated. Despite this, looking at the practical implementation of guarantees provided to consumers, it seems that the interests of borrowers are not adequately protected.

I fully agree with the position of some experts who note that Russian legislation is aimed rather at protecting the interests of creditors than borrowers. Due to the fact that on average Russian population has low solvency and certain risks and non-repayment of loans, insurance systems for such risks associated with the insolvency of borrowers are very popular in order to secure the lender and ensure the principle of repayment of the loan. Likewise, another example of the fact that the consumer lending system reliably protects creditors is the availability of borrowers' credit histories. Database of credit histories allows a creditor to understand at an early stage of the conclusion of a credit agreement an ability of a potential borrower to pay it back. Given that, a lender is able to sensibly and carefully assess the risks when issuing a credit.²³

Obviously, banks initially have greater economic and legal capabilities, that is, the lender is in a stronger economic side. This, in its turn, is a reason for numerous abuses and violations of the rights of borrowers by banks and other credit organizations when concluding consumer credit agreements.²⁴

In this regard, it is extremely important to consolidate the principle of transparency at the legislative level and shift the focus to this principle as a sufficient guarantee of consumer protection when concluding a loan agreement, as is done in the EU. As found out, the principle of transparency is to provide borrowers with maximum access to information about the lending system as a whole and conditions of a specific credit provided by a certain credit institution. Indeed, in order to increase the financial literacy of the population, ensure the proper level of credit services provided by credit institutions and increase the responsibility of both a lender and a borrower in credit relations, it is necessary to ensure transparency of consumer lending. Furthermore, it is extremely necessary to pay more attention to the pre-contractual stage. In light of principle of transparency, it encompasses sufficient and reliable information about the terms of a credit agreement, so that a consumer will have a complete picture of the potentially taken obligations.

²³ КУЗЬМИНЫХ, Галина: Особенности заключения кредитного договора. Правопорядок: история, теория, практика. 2016/1 (8) 28-31. [KUZMINYKH, Galina: Special Features of the Loan Agreement. *Law and order: history, theory, practice*. 2016/1 (8). 28-31.]

²⁴ РАФИКОВ, Р. – ЧЕРЯЧУКИНА, Е.: Потребительское кредитование в Российской Федерации. Современные тенденции развития технологий и науки. 2016 / №12-6. 136-139. [RAFIKOV R.R. – CHERYACHUKINA E.A.: Consumer Lending in the Russian Federation] Available online on: https://apni.ru/media/Sb_k-12-6.pdf#page=136 (accessed: 2021.09.13).

3. Summary

Summarizing review of the EU practice in the field of consumer lending, a number of recommendations aimed at improving the Russian practice of ensuring the principle of transparency in credit agreements for consumers can be formulated, in particular²⁵:

- to demonstrate in free access for familiarization to individuals in banking organizations and retail facilities that sell goods using a bank loan, drafts of credit and other agreements (for example, insurance contracts, a bank deposit agreement, etc.) if their conclusion is carried out together with the conclusion of a basic credit agreement.
- to exclude the practice of using complex semantic constructions in credit agreements, including those containing numerous references to the clauses of the concluded agreement, local legal acts of the bank, as well as other sources of information posted on the bank's website.
- before concluding a credit agreement, to explain to individuals the consequences and procedure for early repayment of the loan, termination of credit agreements.
- to develop and adopt a specialized act of the National Bank on the regulation of transparency of credit agreements, in which, according to the experience of European countries, commercial financial organizations are required to attach to each banking contract and in general in their offices a brief information statement detailing the most important clauses of the agreement.

In conclusion, it should be emphasized that the implementation of the proposed measures in the consumer credit lending practice of Russia will increase the level of transparency of the terms of credit agreements for consumers, which will significantly improve their quality, as well as ensure information transparency of the Russian banking services market.

²⁵ ERZHANOVA 2020 op. cit.