

THE IMPACT OF ABUSIVE CLAUSES LITIGATIONS ON PROFITABILITY OF ROMANIAN BANKS

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Abstract

The banking sector has a special significance in each country's economy, being a constant concern for the authorities, both at national and Community level. To reduce the substantial differences between national laws on consumer credit, the European Commission issued Directive 2008/48/EC on credit agreements for consumers, transposed into Romanian legislation by the now legendary, Emergency Ordinance nr.50/2010. But what followed after the adoption of this ordinance surpassed imagination: some banks refused to make the adjustments provided by the law and they were sued in an enormous proportion by their customers, the consequence was very natural: huge losses and negative advertising. Instead, the banks which have complied with the directive came out very well from the crisis: greater number of customers, increased market share and, ultimately, an unexpected profit for this time of crisis. This article treats „the war between banks and their own customers” and mainly its winners and losers.

Keywords: bank, customers, abusive clauses, litigation, profitability

JEL Classification: D18, K12, K41, K42

1. Introduction

The present article has as objectives the presentation of the features consumer-credit institution relationship and the major changes that have occurred since the adoption of Ordinance 50/2010 in the Romanian banking market, and also the determination of how abusive clauses trials influenced the profitability of the banks.

The research methodology used to achieve the objectives was based on the analysis of literature review, completed by a content analysis of the legislation applicable in the field, reports of authorized institutions (National Agency for Consumer Protection and Competition Council). It was also realized a practical approach, especially a statistical analysis in order to establish the connections between the nationality of the banks on the Romanian market, the number of processes promoted by the respective banks' disgruntled customers and profitability.

The process of European integration for banking market involves the accomplishment of some conditions, and one of these implies the competition policy - which, in the EU concept, aspires to the ideal situation of perfect market - with the purpose of increasing competitiveness. For banking market to turn into a perfect market the following requirements should be cumulatively fulfilled: uniformity of banking services and products, market transparency and atomization, freedom of entry and exit from market (de Haas and Lelyveld, 2006).

The imperative of consumer credit regulation at Community level emerged after a series of reports and consultations carried out by the European Commission, which reported significant differences between the laws of EU countries in consumer loans. An examination of national laws showed that Member States use different mechanisms of protection for the banking consumer, due to diverging national, legal or economic situation.

The banking contract, being essentially a contract of providing services, requires the existence of information and referral obligations as accessory to customer service provided by the bank, the service being realized in the most useful manner for the customer. Therefore, between the information obligation and banking service providing there is a connection (Ahlsvede, 2011).

The obligation is limited at the information and recommendations concerning the contracted service: under what conditions is this provided and if the service is suitable to the customer's needs. From this point of view, the bank is obliged on the one hand to present to the customer the whole picture of the legal effects of the contracted services and on the other hand to propose feasible alternatives, so the customer's option to be exercised in full knowledge. Simultaneously, the client's consent must be expressed in full knowledge of the content and effects of the banking contract, from which derives the bank's obligation to inform the client. The bank is obliged to inform the customers about all the conditions of the contracts and bank mutual commitments.

Lately, we notice a lot of requests for lawsuits brought by customers against banking institutions, regarding either the cancellation of various clauses in credit agreements and repayment of the sums already paid or cessation of the respective clauses. The clauses appreciated as abusive are the most diverse, regarding: the unilateral increase of fee interest or perceived risk commission, unilateral modification of annual percentage rate or the level of fees, unilaterally declaration of early maturity and subsequent obligation of loan repayment, interdiction clauses on construction, rental, etc.

The law no.193/2000 defines the abusive clauses as unfair terms which were not negotiated directly with the consumer, and which, by themselves or with other terms of the contract create in the detriment of the consumer and contrary to the requirements of good faith, a significant imbalance between the rights and the obligations of the parties.

The relatively high framework of the definition caused many processes requiring the courts the sanctions by nullity of various unfair terms in the contracts concluded by the banks with their customers. Often used arguments, as the lack of transparency and equivocations of these terms, or the requirement of specialized knowledge for their understanding, represent issues outlined in article 1 of Law No.193/2000. Furthermore, article 4 of the same law provides that a contractual provision which was not negotiated directly with the consumer shall be deemed abusive if, by itself or together with other provisions of the contract shall be, to the detriment of the consumer or contrary to good faith requirements, a significant imbalance between the rights and obligations of the parties. By this provision, it was intended to eliminate discretionary element in the contractual relationship between commercial entities and individuals, given the lack of balance and the possibility of abuse in the field.

The OECD report, Competition and Regulation in Retail Banking (2008) noted that customer mobility and possibility of choice from different credit offers are essential to stimulate competition in retail banking. Also it states that, generally the customer mobility is low and the client-bank relationships are enduring as a result of high switching costs.

Susan L. Rutledge in Consumer Protection and Financial Literacy (2009) states that: in Eastern Europe, a consumer financial protection regime should meet three objectives. First, the consumers should receive accurate, simple, comparable informations about financial products or services before and after their purchase. Second, the consumers should have access to effective mechanisms, timely, cheaply cost litigation against financial institutions. Third, the consumers should be able to receive financial education when and how they want. A common problem for Eastern Europe countries is the need of adequate institutional structure for consumer financial protection. However, independent of institutional structures, the financial consumers should have a single agency to deal with complaints and inquiries. Financial institutions should be required to apply fair, non-coercive and reasonable best practices in selling and advertising products and financial services to consumers.

2. Characterization of consumer-credit institution relationship on Romanian banking market

In Romania, the banking market imperfection, caused by the failure in achieving the characteristics of the optimal banking market, is prominently outlined in this period of tension between customers and banks, due to the existence of abusive and discretionary clauses in credit contracts, and the adoption of Emergence Ordinance nr.50/2010 and the New Code of Civil Procedure.

The transparency of banking products requires that the physical or legal persons who have not extensive knowledge of banking theory and practice to be able to understand the information from a banking agreement; so its terms must be accessible, undeniable, understandable and visible.

The most important element into the transparency of the banking services market was the adoption of Ordinance nr.50/2010 on credit agreements for consumers. The main novelty provisions from previous legislation include (Piperea, 2012):

- The constraint of practicing a prepayment fee of maximum 1% for fixed-rate loans;
- No charging prepayment fee for variable interest rates loans;
- Limitation of the number for charged fees to the credit agreement relating to: loan administration; sanction for late payment, repayment (unless fixed interest) and unique (only for services provided to consumer demand); additionally, the bank has the right to charge only the commission for the analysis of the file (if it accepts the credit) and the related fee on insurance costs (only for cases where insurance is provided, excluding overdraft contracts, consumer credit);
- Express prohibition of practicing fees for cash transactions for the payment or withdrawal of credit tranches;
- The obligation to calculate the variable interest in a transparent manner: the formula has the mandatory reference ROBOR / LIBOR / EURIBOR / BNR reference rate; the fixed margin can be changed by the bank during the contract only into the consumer's favor; the interest recalculation is done at mandatory timeframes provided in the contract;
- In case of new contracts, before signing these, the bank is obliged to submit a standard form to the consumer with all the technical data of the loan, including DAE, interest rate formula and the total amount to be repaid;
- Obligation for the creditor to present to the consumer the credit agreement at least 15 days before signing;

- The consumer's right to cancel unconditionally and without justification, within 14 days after signing on a credit agreement.

The introduction of this ordinance meant for the banking market a „resetation” of the relations between banks and customers, as well as a formidable weapon for clients against unfair practices from the banking sector. Regarding the number of complaints made by consumers on bank lending market, the year 2010 saw a substantial increase, due to Emergency Ordinance no.50/2010 for credit agreements for consumers, the bank credit market being the first among the most complained consumer markets. Thus, as can be seen in Table 1, until the Emergency Ordinance no.50/2010, the share of total banking sector complaints was less than 1%, after this time, the banks have become the negative star of the deck with weight of more than 8% (NACP, 2013).

Table 1 The number of complaints registered at the NACP related to banking services

	2008	2009	2010	2011	2012
Number of petitions	417	575	10673	5178	4869
Percentage of total complaints	0.8	1.1	16.5	8.8	8.1

Source: National Agency for Consumer Protection (NACP)

Based on the huge number of complaints against the banks, the National Agency for Consumer Protection controlled the banking system and found serious failures in compliance with the regulations of consumer credit by banks (NACP, 2013). The most significant misconducts by banks are presented in the following table (NACP, 2013):

Table 2 Abusive practices of banks in relation to customers identified by the NACP

Obligation of banks	Misconduct
Consumer Notification: presence of the lists with interest, fees and commissions	- failure to update the list with interest on day - non-exposure to visible place for the list of interest and commissions
Prior information and in writing of the consumer, using the "Standard Information European for Consumer Credit"	- no handing form at least 15 days before the contract was settled - failure to specify the assumptions for the calculation of the DAE - failing to mention the applied penalty interest and its calculation - information was written in lower characters than those legally provided
Fulfillment of contractual provisions	- no mention of the total amount payable calculated at the conclusion of the contract - not setting penalty interest as a fix percentage - imposing certain insurance companies for property pledged as collateral or mandatory life without the consumer's opportunity to choose
Respectation the right of withdrawal	- limiting the right to notify the bank in 14 days and no later than 30 calendar days from the dispatch of the notification while the customer can pay the amount without any unjustified delay
Right of early repayment	- Conditioning the right of early repayment, only after written notice at least three days before the repayment date without any compensation, although the consumer has the right at any time to discharge all or part of the obligations
Advertising materials	- advertising brochures did not contain information on the annual percentage rate, duration, total amount payable by the customer and the value rates - specification of banking product 100% free, not to mention that the operations are commissioned in accordance with the fee schedule
Compliance with the law on abusive clauses	- clause stating that the bank reserves the right to declare the loan due in advance and considered the case of default if „economic and financial situation of the borrower records levels below those considered to credit approval" and if „there is a situation / fact / event that may have a negative effect on the financial position or on its ability to properly perform its obligations” - clause regarding "the right to unilaterally modify the contract bank / credit costs, with no good reason"
Other aspects of consumer information	- Not mention the payment commission of the file analysis, although its value is reflected in the total amount of credit - Lack of services demanded by consumers that do not fee

Source: National Agency for Consumer Protection (NACP)

Finally, frustrated by tensions and abusive practices of the banks, in relation to them, the customers have sued banks; and more cases received final judgment in their favor.

3. Research methodology

To achieve this analysis, were studied all 32 universal profile banks operating in our country. From our analysis were excluded BCR housing Bank and Raiffeisen housing Bank because of the niche which it operates. The data necessary for the study were collected from banks, the National Bank sites and client processes against banks on the website of the Ministry of Justice.

Table 3 Main indicators of the first 15 banks in Romania

Bank	Balance sheet assets (bn lei)	Market share 2012	Market share 2011	Financial results (million)	Number of processes
BCR	70.6	19.3	20.1	-1200	3411
BRD	47.9	13.6	13.9	-332	330
BT	29.3	7.3	6.2	+320	404
CEC	26.7	7.0	6.4	+67,4	297
Unicredit	24.3	6.4	6.0	+865	495
Raiffeisen	23.4	6.7	6.5	+362.88	563
Volksbank	16.5	5.0	5.8	-630	5277
ING	16.5	4.1	3.6	232	439
Alpha bank	16.5	4.7	6.2	-28.1	2763
Bancpost	12.1	3.5	3.9	-207,65	4011
Piraeus Bank	7.7	2.3	2.7	-87	2518
Banca Românească	7.0	2.1	2.2	-14,37	2366
Garanti	6.6	1.7	1.8	+51	396
Citibank	6.2	1.6	1.4	+104.9	312
Credit Europe	5.1	1.3	1.4	84	586

Source: sites of the banks, NBR and Minister of Justice

For each of the 32 banks with universal profile operating in our country, presented in Table no.3, were studied the following elements: nationality of banks, the number of processes promoted by the respective banks' customers and profit.

For each of these elements it has been divided in several instances, pointed from 1 to 5, as follows:

- Number of client processes: 1 - small (0-500), 2 - medium (500-1000) 3 - large (> 1000);
- Financial results: 1 loss, 2 profit, 3 large profit;
- Nationality capital: 1 Austrian, 2 domestic, 3 Greek, 4 other.

In this study, it was used the method of **Factorial Analysis of Multiple Correspondences (FAMC)**. FAMC is a multivariate analysis method which is applied in the study of associations between several categorical variables (Andrei and Bourbonnais, 2008).

The factor analysis can be applied to multiple correspondences to study links between categorical variables X_j with $j = 1, p$. The table with original data has the following form:

Table no.4 General form of data table in FAMC

Statistical unit	X_1	...	X_j	...	X_p
1	X_{11}	...	X_{1j}	...	X_{1p}
2	X_{21}	...	X_{2j}	...	X_{2p}
...
i	X_{i1}	...	X_{ij}	...	X_{ip}
...
n	X_{n1}	...	X_{nj}	...	X_{np}

Total number of categories for the variables X_j is noted by m . Total factorial axes is equals, in FAMC, with $(m-p)$. The point cloud inertia (sum of eigenvalues) is equal to the average number of categories decreased by one unit and it is calculated by the formula:

$$In = \frac{1}{p} \sum_{i=1}^p m_i - 1$$

Also, it is interesting the variable contribution to total inertia. The inertia of category for qualitative variable is given by:

$$I(j) = \frac{n_j}{np} d^2 = (1 - \frac{n_j}{n}) \frac{1}{p}$$

The total inertia of a variable is equal to:

$$I(X_i) = \sum_{j=1}^{m_i} (1 - \frac{n_j}{m}) \frac{1}{p} = \frac{(m_i - 1)}{p}$$

The absolute contribution of a variable is:

$$CA(X_i) = \frac{I(X_i)}{\frac{1}{p} \sum_i (m_i - 1)} = \frac{m_i - 1}{\sum_i (m_i - 1)}$$

The absolute contribution is the more important as the number of categories of the variable concerned is higher.

The interpretation of factorial axes according to the contribution of active modalities to the total inertia of projected cloud respects two basic (Voineagu and Țițan, 2007):

- The classification of methods in descending order according to their absolute contribution and then, starting from the first row rank extraction methods for their contributions absolute amount to be between 50 and 80;
- Consideration of methods whose absolute contribution is superior to absolute average contribution, which is equal to 100/number active ways.

4. The research results

The research results were obtained by testing the hypotheses outlined above, as follows: between nationality banks on the Romanian market, the number of processes promoted by the respective banks against their customers and profit there is a connection of statistically significant.

After processing the data in SPSS, using FAMC, the following results were obtained:

Table no.5 Eigenvalues for the first two factorial axes

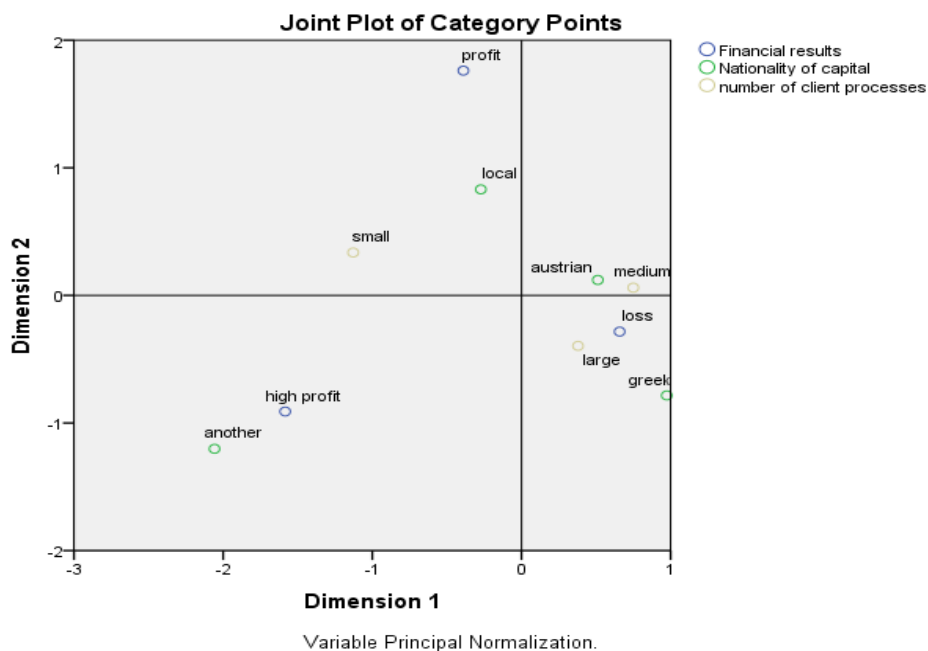
Dimension	Cronbach's Alpha	Variance Accounted For		
		Total (Eigenvalue)	Inertia	% of Variance
1	.853	2.318	.773	77.279
2	.484	1.476	.492	49.208
Total		3.795	1.265	
Mean	.709 ^a	1.897	.632	63.244

a. Mean Cronbach's Alpha is based on the mean Eigenvalue.

As mentioned above, the number of factorial axes which it is interpreted in FAMC corresponds to the eigenvalues greater than 1 / p. For our situation, the first two factorial axes explain the largest differences among the observed variables. Thus a first axis explains 77.27 percent of the total variance and the second axis 49.2.

Graphical representation of the variables in the first two factorial axes system is as follows:

Figure 1 Graphical representation of variables in the system of the first two factorial axes



Source: own calculations using SPSS 17.0

The diagram shown in Figure 1 shows the relationship between the categories of statistical variables.

The domestic capital banks are the winners of the financial crisis period of and the relationship with their customers: records high profits and they are also involved in just a few lawsuits. Other favored financial entities are the banks of another nationality (Turkey, USA, Netherlands, Italy, and France): recorded a small number of processes with their customers and small profit.

However, the banks, which have Austrian and Greek capital, are the losers of relationship with their customers. The Austrian banks (BCR, Volksbank) recorded a total of 3,000 trials, which negatively influenced their financial results (strong loss of 600 million). Instead, Greek banks are „a little better”: the number of processes is between 2000-4000, and the losses are not so high (between -14 and -200).

5. Conclusions

The analysis in our article is also confirmed by NBR study regarding the effects of the new Code of Civil Procedure, and particularly the uniform and full application of abusive clauses from a contract to all credit banks on the market. Thus, according to this study (also asked by banks and the IMF), if they eliminated all abusive clauses from bank contracts, the losses for banks would stand at 5.2 billion lei (1.3 billion Euros). The most affected banks by the loss would be according to the NBR study and to our article, the two Austrian banks, BCR and Volksbank.

The banks which have respected their customers were also respected: the customers have not filed costly lawsuits to them, they are still calling their services, and despite the delicate macroeconomic situation, some of them had even unexpectedly substantial profit. This is the case of banks with local capital and other capital different from Greek and Austrian.

Instead, the banks which have used deceptive methods in relation to their customers (Austrian and Greek banks) have not only been sued by their customers for violation of their rights, but also benefiting from a „negative advertising” and have registered losses, some of them even significant (BCR and Volksbank). One thing to note is the fact that the banks which have the highest number of lawsuits with their customers (BCR 3400, Volksbank 5200) recorded the largest banking losses of over 600 million, which shows that, in the end, those who are always right are the customers.

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