CREDIT, BANKING SERVICES AND CONSUMER PROTECTION IN TIMES OF RECESSION

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I. Introduction

This article intends to analyze credit and banking services problems under consumers' reality, whose protection by the Brazilian Consumer Defense Code (CDC) was intensely disputed by banking and financial institutions, including by questioning the constitutionality of its text under the argument that it infringed the constitutional provision that sets forth that any legislation that regulates the financial system will be necessarily approved by a declaratory statute aimed to complement the constitutional text.

After a Declaratory Judgment of Unconstitutionality (ADIN) was rendered by the Brazilian Federal Supreme Court in favor of consumers, a new phase has started where the institutions that render services intend to institute a Self-regulating banking system.

During these days of economic recession, the protection to consumers against the services rendered by financial, banking and insurance institutions becomes particularly important to prevent over-indebtedness, a situation that is harmful both to consumers and the market as a whole. In this context, the initiatives of the Brazilian Government are commendable, such as the institution of the Brazilian good consumer credit record that lists consumers reputed as good payers, and the new credit card regulation that sets forth standard charges and increases the minimum percentage on total payment. Some measures should still be implemented, such as the incentive to financial education directed to raise consumers' responsibility and awareness about the market.

The contemptible pragmatism imbedded in the reasoning of high governmental ranks, however, gives rise to doubts about their sincerity.

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Considering, *apriori*, eventual abuses practiced against consumers of credit and banking services as a minor evil in face of the global crisis and the need to strengthen the state economy seems to address the interests of financial institutions rather than consumers.

The judiciary will be incumbent on setting limits, not only by granting effective redress to damages eventually ascertained, but by imposing severe repression against harmful actions or inactions already perpetrated by the government and other entities, even jointly, or by formally affirming that several standard contractual clauses and illegal bank practices contradict bedrock principles protected by the Constitution.

II. Credit, Banking Services and the Reality of Consumers in Brazil

Banking and financial activities have a deep impact on the daily lives of the entire Brazilian population that uses them, even involuntarily, to pay and collect salaries, pensions, taxes, fees, accounts and purchases, and to make loans and investments.

For instance, in 2007, the Brazilian banking system made over 37 billion transactions, most of them in more than 18,000 branches spread out nationwide.[1]

In 2010, this figure had increased to 55.7 billion transactions, inclusive of Internet banking, ATM's, call centers, bank cards and branches, and the population's preferred choice is the ATM, with 17.8 billion transactions, equivalent to 31% of total transactions.[2]

The economic crisis that arose in 2008-2009 as a development of the international financial crisis was, on its turn, precipitated by a sequence of breakdowns of large financial institutions that had granted high-risk mortgage credits, and started with the bankruptcy of the traditional North-American investment bank Lehman Brothers.

1 BRASIL: Febraban. Código de Auto-RegulaçãoBancária.Exposição de Motivos para a Auto-RegulaçãoBancária, (2008), p. 2.

2 BRASIL: Febraban. Pesquisa - setorbancárioemnúmeros [Research – banking sector figures]- CIAB FEBRABAN 2011. Available at: http://www.febraban.org.br/Noticias1.asp?id_texto=1243&id_pagina=61&palavra=operações bancárias.

Despite its reflexes in the Brazilian financial system not being significant, such global economic unbalance left consumers in a more fragile situation than before, resulting in the adoption of some measures by legislators.

III. Credit, Banking Services and the CDC

Similar to Continental Europe, the current Brazilian legal system is focused on the existence of codified sectorial statutes interpreted according to the Brazilian Constitution that, on its turn, comprises principles and rules that establish social duties to the development of private economic activities.

In Brazil, the Constitution of 1988 recognized, among other innovations, pressing consumer society needs that required specific legal treatment to new situations that were arising and this was the reason for the creation of a CDC. Likewise, the enactment of the Constitution of 1988 opened a new era for the outdated Civil Code of 1916 that started to be valued and interpreted side by side with several sectorial statutes under the Federal Constitution.

From then on, significant progress has been made to assure effective protection to consumers either as an individual right and a principle of the Economic Order, as set forth in articles 5(XXXII) and 170(V) of the Brazilian Charter. Brazil received its new CDC in 1990, and a new Civil Code (CC) updated to the requirements of the 21st Century in 2002.

The legislator of the CDC of 1990 consolidated such protection unequivocally, and even extended it to legal relations whose purpose is the supply of banking and financial services to consumers, and there was an inclusion of banking, financial, credit and insurance activities within the concept of "services" to be rendered to the consumer market upon consideration (Article 3(2) of the CDC).[3]

Notwithstanding, moved by cupidity, banks and credit and insurance institutions resisted bending to the rules, because they would have to relinquish at least part of their immense profits, earned so easily during the long years of indulgent governmental policies.

3 Arti 3(2) of the CDC: "Service is any activity supplied to the consumer market upon consideration, including banking, financial, credit and insurance activities, except for labor-related activities."

At first, they adopted the strategy of simply ignoring CDC principles and rules, and the Brazilian Central Bank enacted a resolution that was referred to as "Banking Consumer Defense Code" to govern legal relations between banking services users on the one hand, and overall financial institutions on the other. This initiative failed after it was voided by the Brazilian Upper Courts on grounds that it breached rights guaranteed by the CDC.

In late 2001, the financial and banking activities attempted again to not submit to CDC principles and rules, when the National Confederation of the Financial System (CONSIF) filed a Claim of Unconstitutionality in the Brazilian Federal Supreme Court challenging the constitutionality of the above provision (ADIN 2591).

Concerned with the increasing number of judgments rendered on the grounds of the CDC which determined the reduction, albeit partial, of the gains of Banks and other financial institutions (specially gains resulting from interest charges), the CONSIF tried to hinder, at any price, the submission of banking activities to the principles and rules of the consumer protection legislation.[4]

A final decision of the Brazilian Federal Supreme Court rendered in 2006 recognized that banking, financial, credit and insurance services are essential to contemporary life and are characterized by the absolute vulnerability of their consumers. So, such relationship could not be qualified as anything but a consumer relationship. The decision also observed that the argument that the CDC would not be applicable to such activities because its text had not been approved by the majority of the Brazilian Congress (half of its members plus one) had no grounds. Such qualified quorum is indeed necessary for the approval of statutes concerning certain subject-matters, such as laws that regulate the structure and supervision of the National Financial System (article 192). This situation, however, is not related to the situation concerning the legal relationship established between financial, banking or insurance institutions and the consumers of products and services provided thereby.

The judgment passed by the Federal Supreme Court seemed to have put an end to the disagreements about this matter. A few decisions rendered by

4 Even in the administrative sphere, from January to October 2001 banking institutions were responsible for 9,629 consultations and 2,210 complaints recorded in the respective consumer protection agency in the State of São Paulo (PROCON – SP).

Upper State Courts, however, such as the Court of Justice of the State of São Paulo, simply ignored the understanding of the highest Brazilian Court, and even after the decision had been published, some Upper State Courts adopted the position that the services rendered by financial and insurance institutions to consumers should not be governed by the CDC since they correspond to private relationships that are not characterized by a consumerist nature. Such decisions, however, were voided after claims were filed in the Federal Supreme Court based on article 102(I)(1) and article 105(I)(f) of the Brazilian Constitution.

In an attempt to settle its case law, the Superior Court of Justice issued Syllabus no. 281 providing that Trial Courts would not be competent to recognize *sua sponte* the abusiveness of the clauses inserted in banking services agreements.

Such understanding, however, does not hold. The CDC sets forth that its rules are cogent and any contractual provision contrary to such rules will be null and void. Insofar as consumer protection principles and rules are applicable to banking services agreements, and if any clause in such agreement be considered abusive under the CDC, the nullity may and should be recognized by the Court *sua sponte*.

It is true that, within the system of the Brazilian law, the Syllabus issued by the Superior Court of Justice is nothing more than a recommendation to be observed by the lower courts, seeing that it has no binding effect. Nonetheless, it is very concerning because it reflects the reasoning of a court that is lower only to the Federal Supreme Court.

IV. Consumers and the CAB

A. Nature and Structure of the CAB

As the decision whether the relationship between financial institutions and consumers is governed by consumer protection laws evolved, it was ascertained that such relationship would have to be complemented by several other rules, in view of the complex and dynamic nature of the activities involved.

Indeed, the effective application of the CDC to such a legal relationship must be guaranteed both by the judiciary, and by control mechanisms employed by the Central Bank of Brazil, consumer protection agencies, non-governmental organizations and the media.

In a commendable initiative, the Brazilian Federation of Banks (FEBRABAN) changed its line of conduct and with a view of improving existing tools decided to create a Brazilian self-regulating banking system inspired in principles of ethicality, legality, transparence and respect to consumers, adopting self-regulating procedures to be applied by the signatory institutions of the term of adhesion.

Despite the document drafted by FEBRABAN being named "Self-regulating Banking Code", we must have in mind that this is a self-regulating text, whose provisions must be in compliance with the rules set forth in the CDC. Such subordination and dependence are recognized in article 2[5] of such text.

The one-sided and *pro se* "Self-regulating Banking Code" (CAB) is structured in ten chapters[6] and was initially applied in January 2009.

B. Scope of the Proposed CAB

As per the understanding of the Federal Supreme Court that banking, financial and insurance services characterize a consumer relationship, the FEBRABAN established that the scope of the CAB comprises *all products and services* offered or made available by multiple banks, commercial banks, investment banks, savings banks, credit co-operative associations or credit, financing and investment companies that are members of FEBRABAN.

Therefore, it comprises of services that range from Internet banking and ATM services to credit offers that may include overdraft agreements and financing and loan agreements.

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5 Article 2 of CAB: "The self-regulating rules do not supersede but are in compliance with the statutory laws in force, especially the Consumer Defense Code, the laws and rules that are specifically related to the banking system and the performance of activities delegated by the public sector to financial institutions."

6 The CAB states that anyone may participate in the Self-regulating Banking System, lists the regulatory sources and the general principles, the self-regulating banking rules and the liabilities of the signatory parties. According to the text, the signatories will hold meetings to adopt the resolutions, choose their representatives for the Self-regulating Board, which is the ruling and administrative body. The Self-regulating Board, on its turn, may institute sector committees with strict authority to propose and interpret self-regulating conducts, among others, and to issue opinions. It is also provided the establishment of an "Executive Board" under the Self-Regulating Board to act as the executive body of the system. Likewise, it is established that eventual breaches to the self-regulating rules will be ascertained in a disciplinary procedure specifically instituted therefore.

Accordingly, article 3 of the text in question provides: "The self-regulating rules comprise all the products and services offered or made available by the Signatories to any individual, whether a client or not (the 'consumer')."

C. Critics to the CAB

As previously stated, the creation of a self-regulating banking system is a valid and commendable initiative. Some considerations about the subject, however, might be in order.

First, in view of its mere normative nature, the so-called CAB issued by FEBRABAN will not prevail in case any rights granted by the CDC, a federal law with constitutional foundations, are constrained.

Consequently, the provision that establishes that a copy of the agreement will be delivered to consumers only upon request clearly violates the principles of good faith and transparency.[7] This is a rule that collides with article 46 of the CDC where it is set forth that consumers will not be bound by agreements that regulate consumer relations if they do not have prior knowledge of the content thereof, or if the documents have been drafted so as to "make its understanding and scope difficult to grasp".

Neither is it compatible with the CDC with respect to the possibility of banks unilaterally changing the agreements insofar as consumers are notified by a 15-day prior notice[8], or unilaterally adjusting interest rates,[9] except when such adjustment was already provided in the agreement.

Clauses establishing one or the other situation are clearly abusive under the CDC, seeing that article 51(XIII) of such statute determines that contractual provisions related to the supply of products and services will be null and void whenever "they authorize the supplier to unilaterally change the content or quality of the agreement after its execution".

In addition, it is worth stressing that rules which impose liabilities on banks and financial institutions are, quite often, very lenient. It is the case with the time limit to wait in the bank line: maximum of 40 minutes at peak hours

7 Self-regulating Banking Rules, item 4.1(c).

8 *Id*. at item 3.2(e).

9 *Id*. at item 3.3(d).

or 30 minutes during the rest of the working hours, which were reduced to 30 and 20 minutes respectively by the end of 2010.[10]

Lastly, it cannot be ignored that the penalties provided for the branches that do not comply with the established rules are too lenient and lack cogent effectiveness: suspension from participating in the system; a penalty and loss of the right to use the quality stamp.[11]

D. Hypothesis: Relationship with Banking Institutions in the Absence the CDC

A contingent scenario where the application of the CDC to banking relations was not recognized would be desolating, to say the least. This is because of several reasons:i) unreasonable and reckless charges; ii) electronic transaction failures; iii) undue inclusions in SERASA (credit reporting agency); iv) imposition of abusive contractual clauses; v) delivery of products, such as credit cards, regardless of consumer's prior request; vi) optional delivery to consumers of agreements entered into with banking, financial and credit institutions; vii) imposition of the most favorable jurisdiction clause for lawsuits; vii) non-reduction of proportional interest rates and other contractual charges in the event of advanced payment by the consumer; ix) charge of attorneys' fees by the institutions even without the respective court decision; x) consumer's liability in the event of theft or non-delivery of the bank card (based on article 6(VI) and article 20 of the CDC, Brazilian case law understands that this liability is incumbent on the Bank); xi) consumer's liability for the contingent non-delivery of a checkbook sent by mail (article 6(VIII) of the CDC provides for reversed burden of the proof, and such liability is on the bank); xii) default penalty over 2% (before the CDC the average default penalty ranged between 10% and 20%), which is forbidden by article 52(1) of the CDC; xiii) tie-in sale of services (e.g., overdraft and life insurance; loan and insurances), forbidden by article 39(I) of the CDC, among other common procedures that are disrespectful and abusive.

10 Normative SARB 004-09 – Branch Attendance, item 2.1. FEBRABAN rule will be in force for the cities that do not have any laws on the subject. The ordinance of the city of São Paulo no. 13984 of 2005 was challenged by the Federation of Banks that was granted a preliminary injunction by the 2nd Tax Court to suspend the effects of such law in May 2006 on grounds that it is not possible to forecast the waiting time. The Municipality of São Paulo appealed and the Court of Justice of the State of São Paulo (TJ-SP) confirmed the preliminary injunction. The action is currently under examination by the Federal Supreme Court.

11 *Supra* note 7, at article 42.

E. Financial Education and Consumers

In the beginning of the 1980's, the UN Economic and Social Council (ECOSOC) requested to the Secretary General that, taking into account the specificities of each country, the UN should prepare studies with the purpose of creating guidelines for the production of policies and regulatory texts aimed to consumer protection (Resolution no. 62).

As a result, the 39th session of the United Nations General Assembly issued Resolution no. 248 (A/RES/39/248) on April 16, 1985, adopting guidelines for consumer protection included in its annex to be followed by the States Governments. Among such guidelines are specifically included education programs that should become an integral part of minimum school education and information programs, comprising programs about health, product risk, and fundamentals of law.[12]

In Brazil, consumer education is not only part of the principles to be addressed in the preparation of the National Policy of Consumer Relations (article 4(IV) of the CDC[13]), but is also considered as a basic consumer right (article 6(II) of the CDC[14]).

Regarding financial education, consumers should receive all the necessary information both to have access to credit and to be allowed to exercise their option whether to borrow the money or not in an ethical, responsible and conscious manner, weighing all the developments of their conduct. Such stage of development, however, will be attained only if we combine the efforts related to formal education of consumers provided by the school with educational actions outside the school.

12 The document is divided in four parts. The first one establishes the purposes to be attained by consumer defense. The second presents the general principles. Among them, it is worth emphasizing the principle that guarantees consumers' access to proper information and education, and considers the fundamental role of universities and private and public companies in researches in the area. The third part, on its turn, among other guidelines, sets forth consumer educational programs, and should be part of the minimum school education and information system. The fourth and last part provides rules about international cooperation in the subject.

13 Article 4(IV) of the CDC: "The National Policy of Consumer Relations is aimed to address the needs of consumers, respect their dignity, health and safety, protect their economic interests, improve their quality of life, and the transparency and harmony in consumer relations under the following principles: (…) IV – education and information of suppliers and consumers regarding their rights and duties to improve the consumer market; …".

14 Article 6(II) of the CDC: "Consumer rights are basically the following: (…) II –education on and disclosure of the proper consumption of products and services, guaranteeing freedom of choice and equal contractual conditions; …."

The pioneer educational action specifically aimed at ethical and responsible consumer credit services occurred in a joint initiative of Brasilcon and UniCEUB (Brasilia University Center) that issued the online brochure "Responsible Credit". The document intended to explain to consumers succinctly, clearly and objectively the risks of over-indebtedness, was delivered to administrative agencies directed to consumer protection (PROCONS) and civil consumer protection agencies for free distribution.

F. Consumer Credit Protection

It may not be possible for consumers to bear all the responsibility related to the consequences of a loan. Credit suppliers have the duty to be cautious, not to provide credit to those that clearly do not intend to honor their debts or to those that cannot do it because they do not earn enough.

The courts have understood that supplying credit to individuals that are not able to comply with their loan agreements is a real abuse of right, a practice forbidden by article 187 of the Brazilian Civil Code of 2002[15], seeing that such offer would have been made upon a deviation of the social purpose, which is one the bedrocks of the freedom to grant credit.

The credit recklessly granted results in very severe consequences both for consumers and for the very credit market, since, in practice, it induces default in clear violation to the principle of consumer protection and to the constitutional provision of human dignity.

G. Consumer Credit Market Regulation during Recessions

It is worth mentioning some measures adopted by Brazilian legislators to improve the consumer credit market and to protect it from the reflexes of the 2008 – 2009 crisis and the market flotation resulting thereof.

The first measure consists in the institution of the so-called "good consumer credit record". Likewise, specific measures were adopted to better discipline credit card rules (Resolution no. 3919 of the National Monetary Council and Directive no. 3512 of the Central Bank of Brazil).

15 Article 187 of the Brazilian Civil Code: "An illegal act is also committed by the owner of a right that, upon exercising it, clearly exceeds the limits imposed by its economic or social purpose, by good-faith and good behaviour."

H. The Good Consumer Credit Record

One of the most challenging innovations introduced in the Brazilian legal system by the Provisional Presidential Decree no. 518 of December 30, 2010, established that the so-called "good consumer credit record" consisting in a database aimed at the creation of a credit background with information related to the payments made by individuals.

After it passed House of Representatives (05/11/2011) and the Senate (05/18/2011), the Bill of Law was sanctioned by the Executive and became Law no. 12414 of June 9, 2011.

The institution of the "good consumer credit record" has split the doctrine. Authors like Leonardo Bessa, former chairman of Brasilcon, praise the measure, stating that according to the economic literature, "to set aside the *asymmetry of information* and reduce interest rates for good payers, good information has to be accordingly prepared by credit protection agencies".[16]

Others, like IDEC Manager, Maria Elisa Novais, understand that despite the President of the Republic having vetoed[17] some parts of the law that violated consumers' rights, it should be stressed that the approved law is not sufficient to protect consumers if they are not properly informed about their rights and the supervision of eventual abuses.[18]

In fact, consumers have to be aware of some rights that were specially provided for in the new statute: a) consumers must give express authorization and in a specific document or clause for the credit record to be opened and the information shared; b) consumers are entitled to consult their personal credit record at will; c) consumers may enter and exit the existing database at will; and, d) consumers have the right to know which criteria were used to assess their credit approval data.

16 BESSA, Leonardo Roscoe. CadastroPositivo. Available at: *http://www.brasilcon.org.br/web/artigos/artigosver.asp?id=28*

17 After it had passed the Senate, the President of the Republic, at IDEC's request, vetoed the following three articles: a) article 4(3) –allowed information available in the credit record to be accessed and used indiscriminately without consumers' authorization and violating their data confidentiality; b) article 5(1) – did not grant consumers the right to cancel the good credit record at will; and, c) article 5(2) – did not allow consumers to access their credit record information at will, limiting free access to only once per quarter.

18 BRASIL IDEC. *Vitória do consumidor: Dilmavetapontoscriticadospelo Idec no CadastroPositivo*. [Consumers' Victory.Dilma vetoes Good Credit Record points criticized by Idec]. *Idec emação*.Issue of June 10, 2011. Available at: *http://www.idec.org.br/emacao.asp?id=2732*