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Creating consumer protection law vs. responsible borrowing on the consumer loan market

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Abstract

Responsible borrowing means a thorough reflection on the need to become indebted, full transfer of true information affecting creditworthiness, comprehensive analysis of the credit agreement, and refraining from avoiding the repayment of loan obligations. The main purpose of the article is to verify the hypothesis that Polish legislators make only the lenders fully responsible for excessive borrowing on the consumer loan market. The following research methods were used: critical analysis of the subject literature and economic analysis of the respective legal provisions. On the basis of the analyses conducted, areas were identified in which the legislator should use the appropriate legal instruments stimulating responsible borrowing. Among

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

them the following were listed: the consumer's obligation to prove the absence of overdue payments and the consumer's notification of becoming acquainted with the terms of the loan agreement.

Introduction

Since the beginning of the 21st century, we have seen the growing engagement of European and Polish legislators in protecting the consumer on credit markets. In April 2008, the European Parliament adopted a directive on consumer credit agreements (Directive 2008/48/EC). In Poland, the Consumer Credit Law (Law of 20 July 2001) entered into force in September 2002 only to be replaced in May 2011 by a law of the same title (Law of 12 May 2011), and later substantially amended in 2016 (Law of 5 August 2016). On 18 February 2019, a draft law amending certain laws to counter usury was published on the website of the Government Legislative Centre. This briefly documented legislative activity is being explained by the desire to create a harmonised community framework for the functioning of the consumer loan market, the need to combat usury, and the need to stimulate the responsibility of parties to loan agreements, the latter being the focus of this article.

The main objective of the study was to verify the hypothesis that the existing and planned regulations shift the burden of responsibility for credit transactions onto the lenders.[1] These regulations are based on the assumption that a well-informed, educated borrower will behave reasonably to maximise usability. To verify this hypothesis, the method of critical analysis of the subject literature and the method of behavioural economic analysis of legal instruments were used.

The concept and principles of borrowers' responsibility

The concept of responsibility derives from the legal language, and the Latin terms *respondeo* and *responsio*, as used in Roman law, received their equivalents in almost all the European languages of the Middle Ages. They meant "to appear", "to bring before the court", or "to contest charges". Nowadays, the explanations of *responsible* to be found in dictionaries include:

– ready to bear the consequences of their own actions;
– having a duty to see to something;
– guilty of something that should not have happened;
– requiring qualifications and burdened with responsibility;
– giving rise to some state or process (Krzysztofek, 2015).

[1] A lender is a natural or legal person who is the party to an agreement, who grants a consumer loan or credit, or promises to grant a consumer credit in the form of deferred payment.

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

In the broadest sense of the word, the subject literature defines *responsibility* as an ethical norm, which covers the willingness to bear the consequences of one's own decisions.

As Czechowska (2016) stresses, the crises in financial markets gave rise to a surge of interest in financial ethics and demonstrated the need to pursue elementary ethical values like honesty and responsibility in market contracts. The result of exploration of this area of finance was the emergence of the concept of responsible lending. Initially, this concept was seen as the opposite of the so-called predatory lending and referred to lenders only. Nowadays, *responsible* is increasingly used as a qualifier referring to both parties to loan contracts: lenders as well as borrowers (Lewicka-Strzałecka, 2010; Mączyńska, 2018). Hence, Rutkowska-Tomaszewska and Paleczna (2018) attempted to provide both a broad and narrow definition of lending responsibility. In the narrow sense, responsible lending is defined by the authors as awarding loans to creditworthy consumers. However, in its broad sense the term refers to the examination of creditworthiness, lenders' compliance with their obligations, and ethical behaviour of both lenders and borrowers.

Nevertheless, in our opinion, the notional scope of "responsible lending" should be discussed independently from the perspective of the lender and the borrower, and should cover the entire life cycle of the loan service. From the borrower's point of view, the borrowing cycle begins with the loan application submission and ends when the loan is fully repaid. From a lender's perspective, this cycle is extended by the stages related to designing and advertising a loan offer, constructing a loan portfolio, creating loan loss provisions, and – in some cases – debt collection. The different lengths of these life cycles of loan services result in a natural distinction between responsible lending and responsible borrowing.

The principles of responsible borrowing on the consumer loan market are:

– avoiding excessive debt for consumption purposes;

– full disclosure by borrowers of truthful information that may affect the assessment of their creditworthiness;

– getting familiar with the loan agreement with due diligence;

– non-evasion of loan repayment.

These principles and the degree of tolerance of their "circumvention" are part of borrowers' morality. Owing to the limited scope of this article, in-depth consideration will be given to two principles of borrower morality, avoiding excessive debt for consumption purposes and full disclosure of information, as listed above.

Results of empirical research into responsible borrowing of Polish borrowers

Systematic surveys of financial morality of nonprofessional clients on the loan market have been conducted in Poland by Lewicka-Strzałecka since 2016 on the initiative of the Conference of Financial Enterprises. The surveys have included,

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

among others, the phenomenon of nondisclosure of such data as would render it impossible to take out a loan, and the phenomenon of acceptance of loans without a thorough understanding of the contractual terms of loan repayment. The survey results are presented in Table 1.

Table 1. Level of consumer permissiveness in the area of incurring loan obligations

Is it morally acceptable when someone	Survey year	Response frequency in %			
		never	sometimes	often	always
conceals information that would render it impossible for them to obtain a loan?	2018	74.6	21.8	2.2	1.4
	2017	81.9	14.3	1.5	2.3
	2016	83.2	13.6	1.8	1.4
takes out a loan without being fully aware of the terms and conditions of repayment?	2018	67.3	26.0	4.2	2.5
	2017	68.5	25.5	3.3	2.7
	2016	64.1	26.6	6.1	3.2

Source: (Lewicka-Strzałecka, 2018).

As can be seen from the table, the level of acceptance of concealment of information that would prevent granting of a loan has increased over the research period. In 2016, 83.2% of respondents believed that concealing information that would potentially thwart chances of getting a loan should never be tolerated, but as quickly as by 2018 the share of respondents holding this view dropped to 74.6%. Just one in seven people in 2016, but as many as one in five in 2018, was willing to consider that at times such behaviour may be justified. When asked about the reasons for their attitude, the respondents justifying concealment of information most often evoked the dishonesty of lenders (50.8%), more than two-fifths (41.3%) of them considered the need to satisfy an important need to be a sufficient justification, and nearly 7.9% claimed that this was the socially acceptable standard of consumer behaviour. In the group of respondents who believed that it was never justifiable to conceal information potentially preventing a loan grant, more than half of them (55.2%) pointed out the illegality of such concealment, one-third (32.7%) – ethical reasons, and 12.1% – the risks related to such behaviour.

Poles are much more tolerant of borrowing without being familiar with the repayment terms, which may be considered a contravention of being a responsible borrower. In 2018, only around 67% and in 2016, around 64% of respondents declared that such behaviour could never be justified. On average, more than a quarter of those surveyed felt that the reasons for staying unaware of the exact terms and conditions of repayment terms could sometimes be acceptable. Among the respondents tolerant of taking out a loan without a thorough knowledge of the repayment terms, nearly three-quarters indicated that the contracts were long and difficult to understand, more than one-fifth referred to the commonly practiced social standard, and 3.4% indicated the lack of legal sanctions pertinent to such behaviour. Of the group who declared that it could never be justified not to read the loan agreement carefully, 26% of the respondents pointed to ethical reasons, while 65.4% indicated legal reasons.

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

The briefly presented results of systematic surveying of the selected attitudes of Polish borrowers towards responsible borrowing do not, of course, forejudge their real behaviours and market choices. On the basis of the theoretical achievements of research into personal finances, it may be stated that attitudes are only one of the determinants of these behaviours and choices.

Responsible borrowing in the theory of personal finance

The problem of responsible borrowing should be considered on the basis of both the theory of consumer behaviour and the theory of consumer choice. On the basis of the first of these theories, responsible borrowing is related to the problem of financial awareness of nonprofessional loan market participants.

The research on financial awareness was initiated by Bernheim and Scholz (1993), who drew attention to two components of financial awareness and the consequences of its absence: financial knowledge and experience in its practical application. They came to the conclusion that the average financial decision maker, acting in isolation, without experience and with little or no economic education, will not be able to behave rationally, maximizing usefulness. The development of behavioural finance has resulted in the fact that the concept of financial awareness has been enriched by another component, attitudes. Nowadays, on the basis of Polish literature on the subject, the common interpretation of the term "financial awareness" is based on Flejterski's (2008) terminology, created for the purpose of defining superficial and deep financial awareness. According to this terminology, deep financial awareness includes three components:

– financial knowledge;
– financial skills; and
– financial attitudes.

In consumer behaviour theory, a high level of borrowers' awareness means that they are able to identify a responsible level of borrowing. They have a comprehensive knowledge of the desired credit product and of budgeting household expenses, they are able to analyse a loan agreement in depth, and are guided by ethical considerations while their creditworthiness is being assessed.

Potocki (2018) points out, however, that the ability to make a responsible choice is only determined by individual cognitive abilities, skills, and psychological predispositions, that is, factors that are not instruments sufficient to make responsible choices. That is so because the choices made depend not only on the aforementioned internal determinants, but also on the external ones. Lack of access to so-called "instant loans" from banks and loan companies may, in a situation of a sudden and important financial need, result in borrowing from parabanks, which may eventually lead to a debt spiral. A lack of ability to make responsible choices can result in a lack of ability to act or in orientation towards a socially accepted standard of behaviours

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

that are not necessarily responsible. On the basis of consumer choice theory, the behaviour of a responsible borrower is formed by two factors: the personal ability to make a responsible choice and the structure of external conditions that encourage them to make such a choice.

As de Saint-Exupery used to say, "to be a man is, precisely, to be responsible". Philosophers who study this area indicate that man is responsible by nature from the very beginning. There is no need to train man in the skill of responsibility, it is enough to discover this responsibility by oneself or by creating a favourable choice architecture. The term "choice architecture" was coined by Thaler and Sustein (2009). The essence of the term is visualised in the book cover, which shows a female elephant encouraging her toddler to keep going with a delicate nudge. The adult elephant symbolizes a choice architect whose task is to organize the context in which people make choices and to give incentives for the expected choice. Every day, individual financial decisions depend on different choice architects. One of those architects is certainly the legislator, who influences human behaviour by creating and then enforcing the law.

In explaining the concept of choice architecture, its authors refer to the idea of libertarian paternalism (Thaler & Sustein, 2003). According to this explanation, the "libertarian" term should be interpreted as "free to go their own way". On the other hand, paternalism, which is usually associated with a contradiction of libertarianism, should be supportive of the choices made, that is, guide people towards certain behaviours to make their lives longer, healthier, and better. It is worth considering the possibility of applying this concept to the legal regulations regarding consumer protection in the loan market.

Consumer protection regulations vs. selected principles of responsible borrowing

The principles of responsible borrowing selected for consideration here include: 1) full disclosure by borrowers of truthful information affecting the assessment of their creditworthiness, and 2) due diligence in reading the loan agreement. On the other hand, consumer protection regulations are contained in the Consumer Credit Law. According to the provisions of this law, the lender is obliged to analyse and assess the potential borrower's creditworthiness. The analysis should be based, *inter alia*, on information obtained from the borrower in the case of banks and cooperative savings-and-credit unions, and may be based on this information in the case of lending companies. The potential borrower should provide, at the lender's request, the documents and information necessary to perform such analysis. However, in accordance with the provisions of the draft law amending certain laws in order to prevent usury, a loan company should receive from a potential borrower a statement of their income and expenses and verify such a statement against the economic data collected by competent institutions. The statement, together with the information

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

obtained from the relevant institutions, should be annexed to the loan agreement. If a creditor grants a loan without verifying the declaration submitted, he may be subject to severe legal sanctions.

These provisions indicate a clear lack of proportionality in the legislature's treatment of both parties to a loan transaction, which makes it impossible to build trust in the consumer loan market upon the key value, which is the shared responsibility of all market participants. To restore the proportionality, the potential borrower should be responsible for supporting his statement of income and expenditure with evidence, and any evasion should be treated as an attempt to swindle the creditor.

Also, the due diligence of a potential borrower in getting to understand the loan agreement is not encouraged by the legislator as the choice architect. In this situation, the choice architecture focuses exclusively on responsible lending. This is evidenced, *inter alia*, by the provision stating that a borrower who meets the conditions for a loan has the right to receive, upon request, a draft of the consumer loan agreement without charge. The draft should include the potential borrower's data and all the terms and conditions under which the loan might be granted. This is also reinforced by the provisions stating that prior to the conclusion of a loan agreement, the lender/loan intermediary is obliged to provide the consumer, on a durable medium (paper-based form), with the information necessary to make a loan decision and to do so in advance with sufficient time for the potential borrower to get acquainted with such information, as well as to provide him with an explanation of the provisions of the loan agreement. The agreement itself should be worded in a clear and comprehensible way. A good solution would be to introduce the obligation to attach to the loan agreement a borrower's declaration that he has read the proposed loan agreement and understood the financial and legal consequences related to its execution.

Conclusions

The legislature, as the choice architect of the consumer loan market, should avoid any disproportionate distribution of the relationship between lenders and borrowers. The weaker position of a nonprofessional consumer results not only from his lack of knowledge and skills, and the information deficit occurs not only on one side of the consumer loan agreement. A rational legislator should promote responsible lending and responsible borrowing at the same time. Therefore, it seems wise to agree with Nieborak (2016) that "the consumer model should (...) evolve towards perceiving him as a conscious entity which, although unprofessional and not always rational, is nevertheless aware of the complexity of the surrounding world and must take into account the consequences and threats related to his own activities". Consumer protection in the consumer loan market should evolve towards market protection.

Pobrane z czasopisma Annales H - Oeconomia **http://oeconomia.annales.umcs.pl**
Data: 13/09/2026 07:38:38

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