European Research Studies Journal
Volume XXVII, Issue 4, 2024

pp. 890-904

Consumer Choice in Mortgage Loans Cross-Selling

Submitted 08/09/24, 1st revision 15/09/24, 2nd revision 11/10/24, accepted 30/10/24

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Abstract:

Purpose: *Mortgage loans are offered by banks in cross-selling practices with other financial products, of which insurance is the most significant addition product. The main objective of the article was to presents the result of a study whose cognitive goal was to assess the consumer-borrower's ability to choose a home loan offer and to identifying corrective solutions that could enhance the market position of consumer-borrower in the relationship with banks.*
Design/Methodology/Approach: *The study conducted a comparative analysis of mortgage loan offers available on the Polish market in 2022. The study included offers from the 10 largest banks: PKO BP, Bank Pekao, Santander, ING, BNP Paribas, mBank, Millennium, Crédit Agricole, Alior, and Citi Handlowy. The research apply a triangulation method combining various research techniques including interviews, document analysis, and the mystery shopper method.*
Findings: *The results of the survey shows that consumer choice in the mortgage market is significantly restricted. The legislator recognizes the imbalance problem between consumer-borrowers and banks in the mortgage market and regulates rules of tying and bundling practices. However, current regulations remain insufficient. It seems that in this case, consumer choice would become more genuine if lawmaker introduced a minimum level of insurance cover. Reducing the variability in options would make consumer choice more realistic.*
Practical Implications: *The application goal of the study was to formulate recommendations, the implementation of which could strengthen the position of consumer-borrowers in the bancassurance market and thereby contribute to improved efficiency and fairness in the market's operations.*
Originality/Value: *This research reduce existing research gap by showing banks practices in offering mortgage loans together with additional products (particularly insurance). There is a need in economic literature to show the consequences of cross-selling mortgage loans and insurance products.*

Keywords: *Mortgage, collateral of loans, credit protection insurance, bancassurance, consumer protection.*

JEL Classification: *D18, G21, G22.*
Paper type: *Research article.*
Research funding:

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1. Introduction

Classical economics is based on the assumption that consumers are capable of making choices and rational decisions. Restricting choice results in a consumer losing part of their surplus, which is captured by the entrepreneur, and the benefits and costs of the exchange between the parties are divided to the detriment of the consumer. This introduces inefficiency and unfairness in market operations.

The article presents the findings of a study. The cognitive purpose of the study was to assess the consumer-borrower's ability to choose a mortgage loan offer and to identifying corrective solutions that could enhance the market position of consumer-borrower in the relationship with banks. Mortgage loans are offered by banks in cross-selling practices with other financial products, of which insurance is the most significant addition product.

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2. Literature Review

Mortgage loans have become predominant in the loan portfolios of banks in Western countries. Poland is following similar trends and, as a result, we are seeing a steadily increasing credit debt of individuals. At the end of 2023, banks in Poland held 2.3 million mortgage loans, with a total value of PLN 479.3 billion (Amron Sarfin, 2024). The average mortgage loan amount in 2023 was PLN 375,367.

In 2023, banks granted over 162,000 new mortgage loans valued at PLN 62.7 billion. The number of newly granted loans compared to the previous year increased by 28.55%. Additionally, the value of newly issued loans grew by 43.81%, from PLN 43.6 billion in 2022 to PLN 62.7 billion in 2023 wich arised mainly due to the increase in real estate prices that took place during this period.

This increase was primarily generated by an increase in the price of building materials and increased demand. It is important to note that the significant rise in property prices contributes to higher loan amounts and thus increases consumer debt levels.

Offering mortgage loans and insurance is an example of cross-selling, commonly found in the economy. These practices concern offering one service along with another related service or product in an integrated package (Maśniak, 2019). Cross-selling practices may take the form of tying and bundling sales (ESA, 2014) and can bring both benefits to clients as well as create situations where consumer interests may not be adequately considered, thereby leading to significant consumer risks (EIOPA, 2022; Czech, 2019; Szaraniec, 2017).

It is a common practice for banks to combine loan and insurance products in their offers (Benoist, 2002; Bravo, 2020; Norman, 2006; Ranyard and McHugh, 2012; Szczukocka, 2017). Banks, as part of their cooperation with insurance companies – bancassurance – offer insurance that secure loan repayment. None of the insurance linked to mortgage loans are mandatory under Polish law i.e., common law do not impose such requirements. However, banks may require insurance from borrowers and use it as one of the credit security.

Due to insufficient regulations of cross-selling practices (Anderson and Arroyo, 2017; Mišćenić, 2014; Rogoń, 2015), the concept of tied and bundled sales has been defined in Article 4, points 18 and 19 of the Act of 23 March 2017. - Mortgage Loans and Supervision of Mortgage Credit Intermediaries and Agents (Journal of Laws 2022, item 2245, as amended) (hereinafter: Mortgage Act), which was implemented by Directive 2014/17/EU of the European Parliament and of the Council of February 4, 2014, on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (EU 28.02.2014, No 60/34) (hereinafter: Mortgage Directive).

Accordingly, bundling practice refer to „the offering or the selling of a credit agreement in a package with other distinct financial products or services where the credit agreement is also made available to the consumer separately but not necessarily on the same terms or conditions as when offered bundled with the ancillary services." On the other hand, tying practice means „the offering or the selling of a credit agreement in a package with other distinct financial products or services where the credit agreement is not made available to the consumer separately."

As a general rule, tying practices are generally prohibited (Article 9(1) Mortgage Act), but legislator bring into existence certain exceptions. However, bundling practices are allowed. Polish lawmaker has adopted several exceptions to the tying ban from the Mortgage Directive. The first exception concern to a payment or personal account provided free of charge (Article 9(1) of the Mortgage Act). The second exception pertains to contract of insurance.

Article 9(2) of the Mortgage Act specifies that „the creditor may require the consumer to conclude an insurance contract or to have a relevant insurance policy related to the mortgage loan agreement or to transfer the future receivables under this insurance contract to the lender”. Simultaneously bank should inform the consumer about his „opportunity to choose his own insurance provider, provided that his insurance policy has an minimum level of coverage accepted by the creditor.” Moreover, before concluding a mortgage loan agreement, the creditor „is obliged to inform the consumer about the requirements that the insurance contract must meet.”

The ban on tying mortgage loans in a package is motivated by the need to prevent situations in which a consumer interested in the main product—a loan agreement—is forced by the creditor to purchase additional products as a condition for receiving the loan.

The Act does not explicitly prohibit the creditor from changing the financial terms of the loan if the borrower chooses a different insurer. However, changing (worsening) the terms in case of choosing an alternate insurance provider would violate the prohibition on tying and would be contrary to the act.

Insurance can also be offered as part of the bundling practice. In this case, the Mortgage Act imposes additional pre-contractual informational obligations on the bank. The first obligation requires „providing information that the mortgage loan is also available without additional products or services”. The second obligation requires the creditor to „provide an informational form for the mortgage loan offered without bundling” (Article 9(6) of the Mortgage Act).

The legal regulation of the Mortgage Act do not prohibit the creditor from differentiating terms of the loan depending on whether or not the borrower uses insurance protection through the bank’s partner insurer. Therefore, if borrower take out insurance offered in the form of bundling with an insurer of consumer choice, he cannot demand the same loan price as if he had purchased insurance of similar coverage through the bank (Nierodka, 2019).

The group of insurance offered with mortgage loans is broad and diverse (European Commission: Directorate-General for Financial Stability, Financial Services and Capital Markets Union, 2020). Banks can offer both personal and property insurance. Insurances offered with mortgage loans are often available for consumers-creditors in packaged with several insurance products. The borrower does not have the option to unpack the package and purchase a single insurance policy.

Types of insurance products offered with mortgage loans include:

- property insurance against fire and other unforeseen events,
- life insurance for the borrower (in the event of death),
- health insurance (in the event of illness),
- income insurance (in the event of job loss).

3. Research Methods

The study of offer conditions was conducted on a sample of 10 dominant banks in Poland. The research sample was selected to be as representative as possible and included banks with a significant share in the structure of granted mortgage loans.

Bank selection was based on the ranking develop by monthly financial magazine „Bank”. In the 2021 edition of Poland's largest banks „Bank” awarded the top 10 positions to the following banks: PKO BP, Pekao, Santander, ING Bank Śląski, mBank, BNP Paribas, Millennium, Alior Bank, Crédit Agricole, and Citi Handlowy (monthly financial magazine Bank, 2021).

The analysis of the offer structures was conducted using the "mystery shopper" method. For the purposes of the study, a standardized conversation template was created. The study assumed that each bank’s branches apply uniform credit offering principles therefore credit offers from different branches of the same bank were not compared.

4. Research Results

The analysis of mortgage loan offers showed that two types of offers were available on the market. For the purposes of the analysis, they were called as a Type A and Type B. The Type A offer is a basic mortgage loan offer, which included the mortgage loan and additional products required by the lender with a limited extent. The terms of the basic offer are presented in Table 1. Type B offer is an additional loan offer and containing a wide range of additional bank products. The conditions for the additional offer are presented in Table 2.

In Type A offers, the commonly required insurance was property insurance against fire and other unforeseen events, and less frequently, insurance for the borrower’s life. Mortgage loan with property insurance covering unforeseen events is a standard on the mortgage market. There is no mortgage loan available on the market without property insurance against fortuitous event like fire or flood. By requiring property insurance, banks protect the value of the collateral, which is the financed property.

In addition to property insurance 3 banks (Citi Handlowy, Millennium and Pekao), also required life insurance. Of these 3 banks, only Pekao required life insurance on specific conditions. Life insurance is required if the borrower exceeds a certain age, works in a high-risk profession, the loan contract is signed by only one person, or when the borrower is the only or main provider of income in the household.

Both property insurance against fire and other unforeseen events, as well as life insurance, are required for the entire duration of the loan agreement.

Simply concluding an insurance contract does not constitute sufficient security for the bank. Therefore, banks also obligate the borrower to transfer future receivables - the right to the insurance payout- from the insurance contract to the bank (voluntary assignment) or designate the bank as the beneficiary.

The study showed that none of the banks divested borrower from choosing an insurance provider independently. For Type A offers, selecting an insurer other than the one recommended by the bank also did not impact the financial terms of the loan. In Type B offers from among additional products, banks required consumers to hold a savings and checking account with mandatory monthly payments. Additionally, some banks linked a payment card to this account and required the borrower to make a certain number or amount of card transactions each month.

Among other additional products, 3 banks also required a credit card for the entire loan period or for the first few years of the loan agreement. Other requirements included create an account in the mobile application or set up electronic banking account and to agree to electronic correspondence.

Taking advantage of the type B offer also required - quite commonly - the purchase of additional insurance. Life insurance was standard in Type B loan offers. This life insurance was core of insurance packages. Based on life insurance - by extending it with more insurance: health, income - insurance packages were constructed. Borrowers could not „unpack" these packages to purchase individual insurance components separately.

Insurance in Type B were offered by banks in the form of bundled sales. Banks that had such insurance required it from borrowers to own for the first 3 years (BNP Paribas, ING Bank Śląski), 4 years (PKO BP, Pekao), or 5 years (Alior Bank, Crédit Agricole, mBank, Santander). After the specified period, consumer was free to choose insurance from any provider or discontinue the policy without impacting loan terms.

However, if a consumer-borrower took out insurance with another insurance provider of if decided to did not purchase the policy offered by bank, he could not demand loan terms equivalent to those available if he accepted the bank's bundled insurance offer. In this case, the borrower could took out a loan, but under the terms of the Type A offer. All banks that had a Type B offer informed borrower (in accordance with Article 9 (5-6) of the Mortgage Act) that the additional insurance was optional and that the mortgage loan was also available without such insurance. For this purpose, banks presented to the borrower price for the basic offer (Type A) and for the expanded offer, including the additional insurance (Type B).

Table 1. *Type A Mortgage Loan Offer*

	Alior	BNP Paribas	Citi Handlowy	Crédit Agricole	ING Bank Śląski
„obligatory" insurance required	insurance against damages to the property	insurance against damages to the property	insurance against damages to the property, life insurance	insurance against damages to the property	insurance against damages to the property
How long should the insurance contract run?	all along loan period	all along loan period	all along loan period	all along loan period	all along loan period
Does the borrower have the opportunity to choose the „obligatory" insurance from any insurance company?	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan

	mBank	Millennium	PKO BP	Pekao	Santander
„obligatory" insurance required	insurance against damages to the property	insurance against damages to the property, life insurance, health insurance	insurance against damages to the property	insurance against damages to the property, life insurance - in certain cases	insurance against damages to the property
How long should the insurance contract run?	all along loan period	all along loan period	all along loan period	all along loan period	all along loan period
Does the borrower have the opportunity to choose the „obligatory" insurance from any insurance company?	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan	yes and it does not have impact on the terms of the home loan

Source: *Own study based on an analysis of mortgage loan offers.*

Table 2. *Type B Mortgage Loan Offer*

	Alior Bank	BNP Paribas	City Handlowy	Crédit Agricole	ING Bank Śląski
Does the bank have a home loan on favorable conditions?	yes	yes	yes	yes	yes
Use of which products reduces home loan costs?					
Personal account	yes- all along loan period	yes -all along loan period	yes - for the first 5 years	yes - all along loan period	yes - for the first 3 years
Payment card	yes	yes	no	no	no
Other	mobile app	acceptance of electronic correspondence	no	no	no
Credit card	no	no	no	no	no
Additional voluntary insurance	life insurance, health insurance	life insurance, health insurance, unemployment insurance	no	life insurance, health insurance	life insurance, health insurance
Insurance period required by bank	first 5 years	first 3 years		first 5 years	first 3 years
Opportunity to choose any insurer company	no	no		no	no
Impact of additional products on home loan terms					
Lower margin	X	X	X	X	X
Lower commission					

Legend:

(hatched cell) means that the bank did not have an additional product in offer

	mBank	Millennium	PKO BP	Pekao	Santander
Does the bank have a home loan on favorable conditions?	yes	yes	yes	yes	yes
Use of which products reduces home loan costs?					
Personal account	yes - for the first 5 years	yes - all along loan period	yes - all along loan period	yes - all along loan period	yes - for the first 5 years
Payment card	yes - 15 card payments	yes - 500 PLN per month	yes	yes	no
Other	no	no	no	internet banking	no
Credit card	no	no	yes- all along loan period	yes - for the first years	yes - 500 PLN per month for the first 5 years
Additional voluntary insurance	life insurance, health insurance, unemployment insurance	no	life insurance, health insurance, unemployment insurance	life insurance, health insurance, unemployment insurance	life insurance
Insurance period required by bank	first 5 years		first 4 years	first 4 years	first 5 years
Opportunity to choose any insurer company	no		no	no	no
Impact of additional products on home loan terms					
Lower margin	X	X	X	X	X
Lower commission				X	X

Legend:

means that the bank did not have an additional product in offer

Source: *Own study based on an analysis of mortgage loan offers.*

The reasons for choosing a Type B offer can be multifarious. Choosing a Type B offer typically results in a lower interest rate and eliminates or reduce additional fees, such as commissions or preparation fees. This is a common argument used by banks to encourage consumers to select this option.

To obtain a lower interest rate or reduced fees, the consumer-borrower must purchase the insurance offered by the bank. In practice, this means that if the borrower chooses a Type B offer is required to buy the insurance recommended by the lender. Conversely, if the borrower does not chooses the insurance offered by the bank, he will not qualify for the lower interest rate and will have to agree to a loan with a higher interest rate, consistent with the terms of a Type A offer.

The motivation to choose a Type B offer may not result from better financial loan conditions but rather from an increase or the attainment of creditworthiness by the potential borrower. By offering a Type B option, the bank creates an opportunity for borrowers in poorer financial situations to take out a loan. The purchase of additional insurance increases creditworthiness by an average of 20%.

5. Discussion

The circumstances surrounding the choice of a loan affect the match of insurance coverage to the needs of consumers-borrowers. The initiator of the insurance is the lender - bank, which means that the insurance primarily is related with the bank's interests. Borrowers-consumers rarely take the initiative in this regard. Although insurance added with credit also relates to borrower-consumer interests, but it generally prioritizes the bank’s interests over those of the consumer (Nowak, 2019).

Both parties, borrower and lender, are interested in mitigating the risk of loan default. The cessation of loan repayment brings losses to both the borrower and the lender. From the perspective of who is directly beneficiary of the insurance benefit, insurance can be categorized as either protecting the interests of the borrower or the lender. However, this does not fully answer which party's interests are more significantly protected in the insurance relationship.

Besides identifying the beneficiary in the insurance agreement, there are other determinants of the degree of protection include: exclusions and limitations of the insurer’s liability, the coverage amount, and the proportion of the premium allocated to the intermediary’s (bank’s) commission versus the actual coverage.

Additionally, the duration of insurance contracts also indicates that they primarily protect the lender's interests. Insurance offered only for a period of first 5 years does not guarantee adequate protection over the average 25 years of loan repayment. Consumers-borrowers bears greater repayment risks at a later stage of repayment because borrower pays the interest first in the case of fixed installments, which are the most common.

Therefore, insurance policies that are only offered for the first few years does not provide sufficient protection for consumer interests. Of course, banks guarantee the borrower the possibility of extending the insurance for subsequent periods, but an important issue is how many borrowers will be willing to voluntarily use and extend such an insurance contract.

The choice between Type A and Type B loan offers is real only if the total cost of the loan in option A is lower than in option B. Otherwise, there is no rational basis for choosing option A when is more expensive and numer of insurance is narrow. Even low-quality insurance provides some protection for the borrower. In this regard, the criteria for choice was met in the analyzed sample - the total loan cost with additional insurance was higher in each bank than without such insurance.

When consumer apply for a loan there are a number of limitations of choice. In practice, consumer-borrower typically look to their "home" bank first where they hold a personal account or savings account. Only if they encounter issues in obtaining a loan then they consider other banks. This means that if a borrower's bank offers both Types A and B the borrower has a choice. In the study sample, two banks did not haveType B offer, which include additional insurance.

The ability to choose is also limited by the reduction in creditworthiness as a result of the customer's subsequent verification in the BIK (Credit Information Bureau) database which discourages consumers from searching around.

Furthermore, Type B options do not allow borrowers to use insurance from any provider without increasing interest rates, fees, or other charges. Unlike Type A offers, where choosing a different insurer does not affect loan terms, selecting an alternate insurer in Type B results in less favorable loan conditions and discouraging independent searches.

The choice would be more realistic if consumers could select a Type B option without changing the financial terms of the loan while using any insurer. Unfortunately, none of the Type B offers provided this option. Of course, an important question is: how many borrowers actually would be willing to take advantage of such an opportunity?

Banks justify lower interest rates in Type B offers by the lower risk bears by banks. This is rational because voluntary assignment or designating bank as the beneficiary reduces bank risk and justifies a lower margin to cover it. However, there is no justification for worsening loan terms when the consumer uses an different insurer if the insurance coverage meets the bank's requirements. Consumers are deprived of this option in type B offers.

Regardless of the regulator's efforts to improve decision-making conditions, the most of consumers will not use their choice of insurer when taking out a loan. This is due to several reasons. First, insurance is secondary in importance during the mortgage process. Borrowers' attention is primarily focused on the loan, not on insurance or other additional products. In the flood of issues involved in finalizing a mortgage, insurance competes poorly for the borrower's attention. The consumer's attention will be focused on matters like: creditworthiness, monthly payments and total loan cost rather than insurance terms.

Second, consumers lack the factual knowledge needed to make decisions about complex financial matters, including insurance. Defining risks, assessing income, expenses, and assets as a basis for choosing appropriate insurance is beyond the capacity of the average consumer. Expecting active consumer participation in the insurance market is unrealistic and resembles expecting patients to co-manage their medical treatment choices.

Finally, there is a general lack of trust in financial institutions in Poland and low insurance habits. Poles are generally reluctant to use insurance. The negative opinion of the financial sector has been built on the unresolved problems of the franc loan and saving insurance policies which have lowered trust in the financial sector.

6. Recommendations

Cross-selling limits the comparability of mortgage loan offers. The regulator has undertaken various efforts to provide conditions for borrowers to make deliberate decision. These include: the obligation of lenders to provide information in a standardized form, simplifying offers, and granting borrower's right to cancel the loan agreement within 14 days.

Reviewing current regulations on how banks offer insurance, it becomes clear that in cases of tying sales, banks should accept an insurance policy proposed by the borrower if it meets a minimum level of coverage acceptable to the bank. The regulations guarantee the credit institution the right to verify the insurance proposed by the consumer, which, on the one hand, is understandable because insurance secures the loan and should guarantee the borrower an adequate level of protection.

On the other hand, however, this raises the question of whether the bank is the appropriate party to determine and verify the scope of insurance.The stronger consumer protection would be achieved if the national legislature predetermined a minimum scope of insurance coverage for policies added to mortgages.

Setting a certain minimum level of coverage would guarantee the consumer that the insurance protection is not merely superficial. Insurance coverage would also become more standardized, as the minimum conditions would not vary by bank. Of course, banks, in collaboration with insurance companies, could add provisions over those specified by the regulator to differentiate insurance products available on the market.

Additionally, as the law currently stands, this regulation may limit the client's freedom to choose an insurer, making this choice largely illusory. A borrower's use of an available insurance policy is contingent on the bank's approval. It is the bank decision, not the consumer, to accept whether a given insurance policy is appropriate to secure loan repayment.

Borrowers' freedom to choose any insurance company is expressed in ability to obtain several offers and then submits offers over to bank for verification. The final decision and the selection of a specific insurance policy, rests with the bank.

Changing these regulations would mean that credit institutions would no longer have the authority to approve the coverage scope of an external insurer, since the coverage at a minimum level will be uniform and predetermined.

Issues faced by borrowers in cross-selling of mortgages and insurance are solved internationally in various ways. These include (Więcko-Tułowiecka, 2014; Więcko-Tułowiecka, 2017; Ferran, 2012):

- a ban on bundled sales of loans and insurance (France, United Kingdom),
- a prohibition on combining the role of beneficiary of an insurance policy with the intermediary role (Italy),
- a ban on offering more favorable terms to clients who select insurance with an insurer recommended by bank and implementation a requirement for written justification when rejecting external insurance (France),
- introduction of minimum life insurance requirements for contracts linked to mortgages and consumer loans (Italy).

A particularly appropriate solution would seem to be the introduction of a prohibition on changing the terms of the loan if a borrower chooses an insurance provider other than the one proposed by the bank.

Introducing a requirement to accept insurance that meets the lender's minimum conditions, without worsening loan terms, would open the market and oblige banks to review terms offered by different insurers. By establishing minimum insurance conditions, borrowers would learn who and how the insurance protects. This would also raise borrowers' awareness of risks and the level of insurance protection offered.

7. Conclusions

Conducted study shows that consumer choice in the mortgage market is significantly restricted. This limitation is due to several factors, including the complex nature of the financial product (the mortgage) and the structure of the offers. Mortgages are often offered with additional products, such as insurance which adds more complexity to the already complicated loan decision. Not all banks got offer Type B.

The choice is also limited by other factors like: low creditworthiness, focus only on the loan, haste and manipulation by banks. Consequently, consumer-borrowers are unable to effectively perform a control role to ensure efficiency and fairness in the market's functioning.

The legislator recognizes the imbalance problem between consumer-borrowers and banks in the mortgage market and regulates rules of tying and bundling practices. However, current regulations remain insufficient. It seems that in this case, consumer choice would become more genuine if lawmaker introduced a minimum level of insurance cover. Consumer choice would become more viable by reducing variety.

The financial market resebles healthcare market. Creating proper conditions for its functioning is the government 's responsibility. The state must take the responsibility of defining what financial institutions are allowed and not allowed to do.

Therefore, consumer responsibility for decision-making must be limited and shared between the state and financial market entities. Transferring this responsibility to financial entities is ineffective if the state cannot enforce this responsibility.

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