



## European Banking Industry Committee

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European Banking Federation (EBF) • European Savings Banks Group (ESBG) • European Association of Cooperative Banks (EACB) •  
European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS)  
European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)  
European Association of Public Banks (EAPB)

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### **EBiC's Position on the Commission Green Paper on Mortgage Credit in the EU (and London Economics' Report)<sup>1</sup>**

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The European Banking Industry Committee (EBiC) welcomes the Commission's Green Paper on Mortgage Credit in the EU published on 19 July 2005 (Green Paper) and London Economics' Report on the Costs and Benefits of Integration of EU Mortgage Markets published on 5 August 2005 (LE Report)<sup>2</sup>. They clearly reflect the Commission's commitment to the "better regulation principle" that implies wide consultation and preliminary impact assessment. EBiC also welcomes the documents' open approach which leaves room for further discussion. It is with pleasure therefore that EBiC follows the Commission's invitation to comment on the Green Paper.

#### **1. General Remarks**

As a general preliminary comment with regard to the approach taken by the Commission in the Green Paper vis-à-vis the definition of mortgage credit, EBiC wishes to stress the need to acknowledge and take into account the existence of two different criteria for defining mortgage credit in Member States.

One criterion for drawing the distinction between mortgage credit and consumer credit is the guarantee securing the credit. In some Member States a credit is defined as mortgage credit or as consumer credit according to, respectively, the presence or absence of a real estate as surety of the credit. Another criterion of distinction is the purpose of the credit. A credit is a home loan (or a consumer credit) depending on whether or not the objective of the borrower is to buy, build and/or renovate a real estate.

As a consequence, EBiC would urge the Commission to encompass both notions of mortgage credit when analysing the outcome of the public consultation process and assessing the need for any action to be undertaken at EU level (cf. LE Report on p. 12 seq.).

As already stated in EBiC's Political Position Paper on mortgage credit (letter dated 30 March 2005), EBiC members are in favour of further market integration that brings concrete benefits to both consumers and lenders in the framework of the single market. It must be proven, however, that there is a business case for Commission action, i.e. that there is further room for integration and that the expected benefits would outweigh the anticipated costs of the regulation.

In this respect, EBiC would have welcomed a proposal as to the definition of cross-border lending as a form of integration. It believes that such a definition would have been very useful to allow an assessment of the current extent of cross-border mortgage credit and market trends as well as the real obstacles to cross border mortgage lending. Considering the diverse context, from an Industry perspective, the definition of cross-border lending should reflect the economic realities and not be based on a purely legal approach. EBiC therefore proposes the following definition: Cross border lending means any mortgage activity that is

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<sup>1</sup> The structure of this Position Paper follows the structure of the Questionnaire elaborated by the Industry based on the Green Paper on Mortgage Credit in the EU, see Annex.

<sup>2</sup> "The Costs and Benefits of Integration of EU Mortgage Markets", Report for European Commission, DG-Internal Market, London Economics, London, 5 August 2005.

conducted through free establishment, free provision of services, setting up of subsidiaries, Mergers and Acquisitions as well as borrowers crossing borders.

A definition of cross-border lending should however also take into account the internet as a distribution channel to recognise its future potential in this respect. Even if it is not used for concluding mortgage credit contracts at present, it is a powerful tool for advertisement and marketing, which lenders will tend to use increasingly in the future.

Finally and most importantly, it has to be noted that a clear distinction must be made between the definition of cross-border lending and that of integration. Integration should not be measured by the level of cross-border lending but on the basis of market efficiency and market completeness.

In order to assess whether there actually is a business case for Commission action, it is necessary to establish how much room there actually is for further integration of European mortgage markets and whether it is realistic to believe that the removal of the obstacles identified by the Commission in the Green Paper would bring the purported benefits (which outweigh the anticipated costs).

In this vein, EBiC feels it is necessary to re-emphasise that national mortgage markets already are broadly efficient and highly competitive. The EMF/MercerOliverWyman study (EMF/MOW Study)<sup>3</sup> found that there is a very narrow adjusted price range of only 45 bps across 7 of the 8 countries examined<sup>4</sup>, i.e. less than in many national markets. Indeed, in many markets, competition has reduced mortgage lenders' margins in such a way that mortgage loans are often sold with very little return and are used to establish a long-term relationship with the consumer, which in turn allows lenders to cross-sell other products.

This high level of competition in the residential mortgage credit market renders foreign market penetration fairly difficult. Indeed, lenders operating across national borders have to invest to gain the knowledge they lack on the foreign property market in question (the value of the financed property as security (valuation), the available distribution channels, the foreign legal system (transaction and registration of the real security), enforcement procedure and other process-specific information and advisory services) and these additional costs must be incorporated into the mortgage rate, which can reduce competitiveness and prevent a lender from engaging in cross-border lending.

The evidence mentioned above shows that markets are already broadly integrated according to the definition of integration given by London Economics in respect of price (cf. p. 16 seq. of LE Report). If the findings of LE Report are different from the findings of the EMF/MOW Study, this could be due to the fact that London Economics did not work on the basis of adjusted prices.

Were a business case to be proven in terms of achievement of further integration, the obstacles that need to be addressed first by the Commission are those which deter lenders from going cross-border. This is due to the fact that – as far as consumers are concerned - empirical evidence currently shows a fairly low cross-border demand in the area of residential mortgage credit. This low level of cross-border activity is on the one hand owed to infrastructural factors and the very nature of mortgage products which are characterised by their strong links to the property financed and the law of the country where the property is located. On the other hand, experience shows that when the lender crosses the border, consumers are interested in buying foreign mortgage products.

Among the obstacles which deter lenders from going cross-border the Industry has identified in the order of priority: the lack of access to necessary information and registration (credit registers/databases, land and mortgage registers), the lack of certainty and security (valuation, forced sales procedures) and the hampered access to funding and secondary markets. Consumer protection issues are also to be addressed, especially those focusing on the Code of Conduct.

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<sup>3</sup> "Study on the Financial Integration of European Mortgage Markets", Report for the European Mortgage Federation, MercerOliverWyman, London, October 2003.

<sup>4</sup> The countries examined by the EMF/MOW Study were: Italy, the UK, Spain, the Netherlands, Portugal, France, Denmark and Germany.

While identification of existing obstacles, which prevent consumers and lenders from taking full advantage of the single market, is key, from the lenders' perspective, it is equally, if not more important, to prove that the removal of these obstacles will have a direct effect in terms of net benefits. Against this background the findings in LE Report and their hypothetical package have to be assessed.

The Industry believes however that targeted harmonisation (full harmonisation of key provisions which would facilitate further integration, e.g. APRC ) should be used as a means to increase integration of European mortgage markets only when other means have proved to be ineffective.

## **2. Obstacles to Integration: Industry Priorities**

### **2.1 Legal and Related Issues**

- **Client Credit-Worthiness/Cross-border access to national databases**

EBiC would strongly be in favour of any measure ensuring that Member States make cross-border access to national databases possible on a non-discriminatory basis. It believes that non-discriminatory access is a necessary condition to achieve the Single Market in mortgage credit, since credit registers are one of the important instruments to assess the credit worthiness of potential borrowers and therefore to allow the lender to take a decision on a credit request by a consumer.

As a first step, the Commission should promote the collation of information on existing databases in all Member States and the development of a "Memorandum of Understanding" between the owners/controllers of such databases. There should not be any obligation to establish new databases.

In this context it is useful to recap, that the problems with accessing existing national databases stem from their diversity, i.e. the fact that there are positive and negative, private and public and centralised and non-centralised databases.

However, the technical means to facilitate access to national databases by non-national lenders should be discussed in more detail. Likewise, more research should be done on modalities/arrangements for sharing information across Member States, in particular on authorisation to be sought from clients for use of data in accordance with data protection and consumer credit legislation.

Nonetheless, the consultation of national credit registers/databases should not be made compulsory for lenders, their consultation being only one of the tools available to assess client credit-worthiness.

What is more, lenders already are under far reaching obligations to assess client credit-worthiness (e.g. via credit-scoring systems) according to existing as well as forthcoming banking supervision regulation (cf. Basel II).

- **Land and Mortgage Registers**

The variety of registration requirements, the existence of hidden overriding interests and the difficulty in obtaining access to registration systems for consultation and registration are important barriers for lenders wishing to operate cross-border.

Completeness, accurateness and transparency as well as security of land registers are fundamental for any transaction related to real estate. Establishing a certain standard with regard to these principles throughout the EU would enhance a level playing field for credit institutions, since they are preconditions for cross border activity.

EBiC is therefore in favour of measures designed to ensure that the first registered, is the first in right. Moreover, all charges affecting real estate must be registered in the official public land register and should be accessible to any interested party or their representative in order to be binding and to take effect against third parties.

In addition, they should be accurately registered, i.e. not just per day of registration/application for registration but on the basis of the precise moment (hour and minute). This is particularly true with regard to

"hidden privileges", which are non-registered charges on real estate for the benefit of a private or public creditor. According to national law in some Member States, such rights are ranked at a higher level of priority over other collateral regardless of the time at which they came into existence. As a consequence, lenders are very often unaware of their existence, particularly when accessing a land register from abroad. This lack of security is a genuine obstacle to the access of national markets by foreign lenders.

EBiC would support the existence of minimum requirements, especially with respect to the creation, modification, extinction and priority ranking with an acceptable level of transparency. The procedures to be finally retained should be as simple as possible, aiming at avoiding bureaucracy and time consuming administrative requirements for all parties involved. Indeed it should be common sense that filings must be registered and registrations deleted by order of receipt. Any other procedure would harm the reliability of registration and entail a lack of transparency with respect to their priority ranking.

EBiC supports any measure ensuring that Member States provide that the responsible Public Register certifying authority has state indemnity since this is a pre-condition for the efficiency, the credibility and the safety of register systems.

EBiC supports the EULIS project insofar as it implies simplification, higher efficiency and speed of the procedure at a lower cost. It enhances transparency and accessibility by providing easy access to electronic national land registers. As such it contributes to building a single European property market. EBiC would welcome the continued funding of this project by the Commission to encourage its expansion across the EU. In addition, EBiC would welcome to be kept informed by the Commission about the development of the EULIS project.

- **Forced Sales Procedures**

EBiC considers it highly desirable that the Commission tackles the issue of enhancement of a level playing field for credit institutions all over the EU market in the field of forced sales procedures. The value of a mortgage as surety is considerably influenced by the time and the cost that is necessary to realise the surety, which in turn is crucial for low risk of mortgage lending and consequently for low interest rates. For this reason the duration of a forced sale procedure should not exceed a term of two years as recommended in the Report of the Forum Group on Mortgage Credit (Forum Group Report). In this respect, EBiC wishes to stress that lenders only turn to enforcement as a last resort. They can and do adopt a wide range of measures aimed at helping the borrower experiencing financial difficulties before enforcing the surety.

Therefore EBiC strongly supports the option of the Commission presenting a regularly up-dated "scoreboard" making available the relevant information on the cost and duration of forced sale procedures in the EU25. Such a "scoreboard" would help to highlight the best practice at an EU level and to put pressure on Member States with inefficient systems.

Based on the information gathered by the Scoreboard the Commission should then investigate how forced sale procedures can be improved. It has to be borne in mind though, that proceedings in this matter are of national competence.

It remains unclear however, what "more robust measures" as mentioned by the Commission in the Green Paper could mean in practice.

- **Property Valuation**

As far as the merits of a single European Standard for valuation are concerned, EBiC would like to emphasise that it is of vital importance for credit institutions that the local differences in market conditions and behaviour patterns be taken into consideration when assessing the valuation of a property. Such considerations would be extremely difficult to handle in practice if a single EU standard with precise requirements were applied and as such, EBiC feels that such a single Standard would be inappropriate.

That said, EBIC recognises the importance of transparency and coherence for cross-border valuations. In this respect, it would support guidelines for best practices for cross-border lending in appropriate areas i.e. valuation principles, definitions of values and issues related to professional qualifications of valuers.

As an example of guidelines for best practice, the Risk Related Criteria, as stated in Recommendation 27 of the Forum Group Report, could be applied to valuation reports.

With regard to the merits of Commission action to ensure mutual recognition of national valuation standards, EBIC would support the application of the principle of mutual recognition to the area of valuation methodology, in accordance with Recommendation 25 of the Forum Group Report.

Valuation methodology always reflects national, regional or even local market specificities and consequently varies throughout Europe, although there is a degree of convergence in valuation methods in Europe, e.g. the application of the income method for commercial property and/or the application of the comparison method to the valuation of owner-occupied residential property.

The mutual recognition of national valuation methodologies is therefore vital to ensure that the valuation of a property reflects the local real-estate market i.e. that it complies with local legal and tax systems and reflects market participants' behaviour.

An alternative and complementary approach is the use of international standards (IVS (IVSC), EVS (TEGOVA)) or internationally recognised national standards (The RICS Red Book). As such EBIC is in favour of ensuring that a financial institution which lends cross-border is allowed to accept valuations prepared according to internationally recognised valuation standards of its choice, without being subject to additional national conditions and to instruct any valuation practitioner who is a member of an internationally recognised valuation body to carry out the valuation, without being subject to additional national conditions.

- **Applicable law**

The choice of applicable law is a key issue with respect to mortgage lending contracts which should be regarded in a broader context than only mortgage credit.

EBIC is aware of the various EU initiatives related to contract law. These notably include the ongoing discussion on the revision of the Rome I-Convention and the Action Plan on European Contract Law in relation to which the Industry is participating via the Common Frame of Reference network. EBIC would therefore urge the Commission to involve the Industry in the discussions on the revision of the Rome I-Convention at an early stage. EBIC believes that the notion of an active as opposed to a passive provider deserves further examination.

- **Eurohypothec**

EBIC is in favour of exploring the concept of the Eurohypothec<sup>5</sup> designed as a collateral instrument identical in all Member States, which would ideally facilitate cross-border activities, coverage of multiple properties and meet the requirements for securitisation and portfolio management.<sup>6</sup>

A Eurohypothec could be an appropriate optional pan-European mortgage collateral tool, which operates alongside and complements existing national instruments (26<sup>th</sup> regime). Introducing the Eurohypothec through a 26<sup>th</sup> regime could lighten costs in other Member States relating to local regulations and reduce formalities.

It is important to stress however that a strict distinction has to be made between the Eurohypothec as a collateral instrument and the issue of standardisation of mortgage contracts. EBIC is in favour of further

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<sup>5</sup> Instead of "Euromortgage" the term "Eurohypothec" is used in this Position Paper to make a clear distinction between the loan contract and the collateral instrument.

<sup>6</sup> In addition, we wish to draw the Commission's attention to a recent publication made by a study group "Basic Guidelines for a Eurohypothec" outlining the business cases which would benefit from this concept (edited by the Polish Mortgage Credit Foundation, Warsaw May 2005).

exploring the concept of a Eurohypothech. On the other hand and in accordance with London Economics' findings, it is strongly opposed to any measures aimed at standardising mortgage contracts, which would inevitably lead to restriction of the range and number of mortgage products.

That said, the concept of a Eurohypothech needs to be further explored in order to highlight the potential advantages and the extent to which it could improve cross-border lending in legal as well as economic terms. Different national taxes and dues charged with enrolment of mortgages and different rules concerning accessoriness have to be carefully considered (compatibility with national systems).

- **Tax**

EBiC supports the Commission's intention to further abolish any tax obstacles, in particular those that relate to cross-border mortgage lending as they are considered to be genuine obstacles to the Internal Market. Differences in fiscal treatment between local and foreign lenders have to be removed. Additionally, the issue of governmentally applied fees is also considered an obstacle to the Internal Market and it should be investigated and addressed as well.

## **2.2 Funding and Secondary Markets**

EBiC welcomes the Commission's proposal to set up a Funding Group on the aspects of funding of mortgage credit. Access to secondary markets via covered bonds or mortgage backed securities is a top priority for the Industry. In addition, risk diversification through the creation of efficient secondary mortgage markets, optimisation of funding conditions and better capital allocation (e.g. through bankruptcy remoteness of covered bonds or special purpose vehicles, mortgage loans as assets which can be separated from all other assets of the credit institution etc.) would result in efficiency gains, which could directly be transferred to consumers.

EBiC believes that access to and the improvement of funding instruments is an important prerequisite for the integration of European mortgage markets and as such, it insists that the findings of the Funding Group be available before the Commission draws its conclusion and drafts its White Paper in the course of next year.

An important question to be addressed by the working group is whether initiatives in this sector should rather be market-driven or whether there is the need for regulatory intervention. Introducing common securitisation rules in order to facilitate cross-border transfer of mortgages and mortgage collateral could be one of the areas where intervention at EU level would be welcome. Since the transfer of mortgages encompasses legal as well as tax issues market driven initiatives may not be sufficient in this respect.

Indeed, the working group should be tasked to look at all the issues involved and no idea should be excluded at this stage. The Forum Group did not exhaust the potential for innovative thinking in this area and it is most important that discussion is not restricted to issues raised by the Forum Group, since this would represent a serious missed opportunity.

It is important that product variety is not restrained by standardised factors which are determining a pan-European funding market (documentations standards or model definition).

Finally, EBiC would urge the Commission to keep the Industry informed about the participants in the Funding Group meetings and the content of ongoing discussions.

Nevertheless, it has to be noted that the primary mortgage market is of essential importance for the internal market of mortgage credit as well. Differences in the EU Member States concerning own capital requirements linked to different loan to value ratios as well as the importance of the pre-saving period should be taken into account in forthcoming discussions on an integrated European mortgage credit market.

In paragraph 52 of the Green Paper the Commission raised the question of mortgage lending no longer being restricted to credit institutions alone. In this respect EBiC feels that further clarification by the Commission would be helpful. This is especially true, since the issue was not discussed in the Forum Group.

In the context of modern financial structures, insurance companies and pension funds have also started granting mortgage loans to consumers on a moderate scale.

As such EBiC is of the opinion that those non deposit taking mortgage originators should – as mortgage lenders - be subject to the supervision of financial services authorities, notably the regulations designed to protect consumers and promote fair competition. Indeed, if they were not obliged to abide by the relevant sections of banking legislation and to national regimes for mortgage regulation, this would lead to competitive distortions to the detriment of the existing mortgage providers. In addition, it has to be noted that issues of capital requirements (cf. Basel II for banks or Solvency II for insurance companies) have to be considered as well with respect to non deposit taking lenders.

Adherence to the principle “same business, same risks, same rules” is therefore essential to avoid competitive disadvantage. A “one size fits all” approach would be as detrimental to the development of cross-border activity as the maintenance of national barriers to the entry of EU players would be. Therefore, new providers of mortgage credits also have to fully comply with relevant EU financial services regulation, especially prudential rules, insofar as mortgage lending is concerned.

### **2.3 Consumer Protection Issues**

- **Information/Code of Conduct on Home Loans**

EBiC is in favour of maintaining the Code of Conduct for Home Loans (the Code) under its current (voluntary) status, improving its efficiency and facilitating its application to all of the EU Member States. The introduction of binding legislation would significantly undermine self-regulation and would negate the industries enormous efforts and investments to implement and apply the Code. In contrast to difficult legislative procedures, the Code is a flexible instrument, which can be modified more easily to respond to national and European developments and to reflect European funding traditions by avoiding systemic distortions. What is more, the Commission’s scoreboard on the implementation of directives shows that introducing legislation would neither have been any quicker nor more efficient.

The Commission should encourage those countries which have rules in force conflicting with the Code, to bring them as much as possible in line with the Code as endorsed through the Commission recommendation dated 1 March 2001, in order to ensure a level playing field to lenders across borders.

EBiC is convinced that the Code and its European Standardised Information Sheet (ESIS) is the adequate tool to enable the consumers to make informed decisions based on transparent comparison, thus enhancing consumer confidence. By now, it is widely implemented (by approximately 4000 credit institutions across the EU).

The pre-contractual information contained in the ESIS, which was negotiated with consumers, is complete, sufficient, focussed on cost elements and also well balanced in order to avoid information overload. This is consistent with the overall aim of enabling the consumer to make informed decisions when contracting a home loan.

As regards the timing for handing over the ESIS, EBiC believes that the loan-granting processes in Member States, although different, do allow the ESIS to be handed over to the consumer at an early enough stage to shop around and compare offers. Furthermore, the diversity described in the EBiC letter to Commissioner Byrne dated 19 October 2004 confirms the need for flexibility in the way the ESIS is disclosed in Member States, as long as there is still time for shopping around. This point should be officially confirmed by the Commission.

The Code should be extended to apply to certain mortgage credit intermediaries (same business, same risks, same rules). This can be ensured if lenders agree to only work with brokers who adhere to the Code. In this

context the definition of all participants in the mortgage credit mediation process is clearly vital<sup>7</sup>. There are different categories of intermediaries depending on the nature of their relationship with the lender (tight intermediary, broker working with several lenders etc.).

The conditions for a third party/intermediary to be subject to the Code of Conduct as the information regime mandatory for the lender is, that the third party/intermediary must at least have a role to play in providing information to the borrower. Accordingly, "introducers" whose role is merely to identify potential clients for a lender and put them in contact with the latter without intervening at all within the negotiations of any mortgage credit contract, should not be covered by the scope of the Code of Conduct.

In conclusion, EBIC would like to reiterate its support for the request already made in its letter to Commissioner Byrne mentioned above and would like to invite the Commission to send the New Member States a similar letter to the one sent to the EU15 in 2001 endorsing the Commission recommendation dated 1 March 2001 and inviting them to comply with the terms of the Code of Conduct. EBIC believes that this is not only the appropriate official action vis-à-vis the New Member States but also represents a necessary positive signal of support from the Commission, which will encourage the Industry to achieve the necessary complete adherence to the Code.

- **Advice Provision and Credit Intermediation/Duty to advise**

EBIC supports the improvement and harmonisation of the information to be given by the lender to the consumer as designed by the Code of Conduct and its ESIS. It considers however that the consumer should have a similar obligation to provide the lender with adequate information regarding his personal circumstances.

EBIC opposes the introduction of a compulsory duty to advise. The responsibility of the lender is to give exact and adequate information to the consumer. Once the consumer has been completely informed, it is his responsibility to take the final decision as to which product best suits his needs. It is also his responsibility to assess that he will be able to meet his repayment obligations. This important principle was discussed and agreed upon with the Consumer Associations during the negotiations on the Code of Conduct. It is expressly mentioned in the Code. Furthermore, the ambiguity of such a concept would render positive or negative evidence very difficult and lead to a dramatic increase in litigation. In addition, a duty to advise would impose an information overload on consumers that would be counterproductive leading to consumers failing to study relevant information or forgoing the opportunity to shop around.

What is more, the provision of advice being a service *per se*, it should be left to the choice of the parties and submitted to competition. The borrower should remain free to ask for it if he so wishes. Similarly, the lender should not be obliged to provide such a service if he does not intend to offer it.

Any duty to advise would cause additional cost which the consumer would have to bear in the end. In addition, delays would be injected in the credit granting process to the detriment of both lender and consumer.

Furthermore, advice should remain a matter of choice since the reason for and the extent of advice required may differ from case to case. If advice was provided by the lender or the intermediary to the borrower it would by definition be a tailor made, personalised service, which cannot be standardised. Otherwise it would not correspond to the consumer's individual situation. Therefore, only an optional provision of advice can assure that the consumer's needs are appropriately met and that the credit institution is able to build up a relationship with the consumer according to the individual needs of the latter. If the provision of advice was

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<sup>7</sup> The Financial Services Authority (FSA) in the UK for example identified no less than four different activities composing what is meant by "mortgage mediation activity"; each of them can be run by four different third parties within the negotiation and implementation of a mortgage credit contract. Those activities are namely:

- a. Arranging i.e. bringing about regulated mortgage contracts;
- b. Making arrangements with a view to regulated mortgage contracts;
- c. Advising on regulated mortgage contracts;
- d. Agreeing to carry one or more of the activities under a. to c.

made compulsory and a standard for this advice was to be introduced, the content of the advice to be given would have to be laid down in a precise and detailed manner. This could stifle innovation particularly in the field of flexible products (which the Commission wishes to encourage).

What is more, the introduction of a compulsory advice scheme would impair the possible direct distribution of mortgage credits via the internet. A modern and flexible distribution channel promising future growth would be hampered.

EBiC wishes to underline that the final decision as to which product best suits his needs should be left to the consumer. It should not be forgotten that lenders can only assess the suitability of a product for a consumer on the basis of the information supplied by him.

This is without prejudice to the duty to appropriately inform consumers about a product/service requested. Credit institutions need to provide comprehensive information to consumers in their own interest as well as the consumers', irrespective of any obligation.

- **Annual Percentage Rate/Mortgage APRC**

EBiC is in favour of a harmonised APRC (Annual Percentage Rate of Charge) because it is a useful tool for comparison for the consumer and also because it is a fundamental element of the Code's ESIS.

EBiC feels that a single APRC including exclusively those costs levied by the lender for the loan for his benefit is the only way to provide a useful and consistent means of comparison for consumers.

Indeed, the purpose of an APRC is comparability. It enables consumers to compare the products available to them on both national and cross-border basis. The key condition for comparability is that the APRC is calculated in the same way, and therefore includes the same components in all Member States, so that consumers can compare the same piece of information.

As far as the specific cost elements to be included are concerned, as indicated above, the APRC should be based on those costs levied by the lender for his benefit and which are available at the time of the conclusion of the contract. The APRC should therefore include:

- Net interest;
- Administrative fees (file);
- Survey costs (levied by the lender for his benefit), if any.

The APRC should exclude:

- Costs of insurance taken out by the consumer;
- The costs of establishing the security/guarantee. Costs for creating the security, and notably the notary fee, depend on the location of the pledge; the credit institution does not set or charge them and would normally not be able to know their precise amount before the loan contract is signed.

In many Member States the calculation method for the APRC for consumer credits also applies to mortgage credits. As a consequence, the calculation of the APRC for mortgage credits is *de facto* already based on a standardised common methodology following the harmonisation made by the amendment of the Consumer Credit Directive in 1998.

EBiC would like to stress that any proposals to introduce a specific "mortgage APRC" should be based on full targeted harmonisation, i.e. full harmonisation of key elements so that both information and comparison are enabled.

- **Early Repayment**

The right of early repayment should be discussed in the context of specific refinancing conditions available for the lender and taking account of the type of interest rate (fixed or variable) of a given product. Early repayment should be agreed by the contractual parties – equally in all Member States – in a consensual manner. It would be a matter of choice and not a legal right. Standardising this right would interfere with the product design of mortgages and impair their diversity. If the right of early repayment were to become a rule (thus supplementing those Member States that already have regulation or strong traditions for a contractual option to prepay) or indeed in those Member States where it already is, it should be possible for a consumer to waive this right on the condition that he is well informed about the effects of that waiver and its consequences.

Full compensation for the interest rate loss arising from the funding of mortgage loans that are subject to early repayment needs to be assured. Lenders should be entitled to be fully reimbursed for all losses and – for the fixed rate period of any loan – foregone profits that result from the early repayment. Limited compensation would oblige lenders to mutualise its risk, i.e. to divide potential losses among all mortgage borrowers. Experience in some Member States has demonstrated that restrictions on early repayment have squeezed fixed-rate mortgages out of the market.

Therefore the compensation should be calculated on a wide basis (in particular comprising funding costs) without legally enforceable caps on interest rates and on the variation of interest rates. Compensation should either take the form of an early repayment fee or should be included in the interest rate margin. It is up to the consumer which formula he prefers.

EBiC is opposed to legal caps, since such restrictions tend to reduce product diversity. This is in accordance with the view expressed in LE Report with regard to “hard” product restrictions.

The consumer should be informed about early repayment and the consequences thereof in brochures, written offers etc. In individual cases, a transparent settlement should be provided aligned to a published index. It should be noted however, that at the time of the conclusion of the contract, it is impossible to inform the consumer about the exact amount of the early repayment compensation because it depends on factors which are unknown at that time.

As regards consumer education on financial matters this is not only a task for financial institutions but also, and primarily, for governments and consumer organisations.

The Commission should note that the consumer is already informed about any early repayment rights via the Code of Conduct.

- **Usury Rules and Interest Rate Variation**

Usury rules adopted or in their process to be adopted by several Member States have a specific public policy purpose, i.e. to protect citizens against predatory behaviour. They should thus be examined within a broader context than the mortgage credit sector and not dealt with at EU level by a specific initiative limited to mortgage credit.

Usury rules do not necessarily have negative effects for product development and market integration, but this is usually because they are ineffective in influencing the prevailing level of interest charges. They should not be misused by Member States as a form of price control over the mortgage market players. A usurious rate should be identifiable as such following a criterion of public order. It should be noted that for the majority of

Member States an interest rate is considered usurious when there is a clear disproportion between the market rate and the interest applied to the loan.<sup>8</sup>

In this respect, legally enforceable caps on interest rates and on interest rate variability<sup>9</sup> may be problematic due to the fact that interest rates are dynamic. They constitute barriers to market entry<sup>10</sup> and hamper the development of certain products notably those associated with equity release. They also lead to the restriction of access to credit for certain consumers.<sup>11</sup> As such, they hinder product innovation rendering the promotion of more flexible products more difficult. As a result market integration would be hindered in that consumer choice would be constrained. The integration of EU mortgage credit markets would be hampered with regard to two main criteria for measuring the degree of integration identified in LE Report namely product variety and product availability.

What is more, such restrictions contradict the principles of risk sensitive credit management and risk adequate pricing as required by the Basel II-Accord.

In conclusion, lenders should be free to modulate the offer without legally imposed caps (cf. LE Report on “hard” product restrictions).

- **Alternative Dispute Resolution**

In EBIC’s view, a clarification on what kind of redress is meant (judicial or extrajudicial), would be needed as a first stage. The existing Alternative Dispute Resolution (ADR) schemes (for example: the Ombudsman procedure) are sufficient. Further evolution of ADR is not necessary. EBIC is of the opinion that there is a lack of knowledge amongst the public of ADR schemes available, rather than a lack of credibility. It seems that this is a matter rather for encouragement than legislation.

Nevertheless, if there were any initiatives in this respect, the concept of ADR should be examined in a broader context than mortgage credit. Following the recommendations of LE Report, the extension of the already existing FIN-NET could be useful for cross-border mortgage credits, based on a closer cooperation among national bodies in order to increase transparency and ease of access at European level.

## **2.4 26<sup>th</sup> regime**

EBIC acknowledges the current, ongoing debates that are being held on this issue at the EU level. It welcomes the Commission proposal to conduct a feasibility study, on which it hopes, as the sector’s representative body, to be invited to contribute in due course.

It is the view of EBIC however that the onus should not be on the Industry to further develop the application of 26<sup>th</sup> regimes in the area of retail financial services via the appropriate test case(s). EBIC would welcome a feasibility/impact assessment of advantages and disadvantages of such a new instrument once in place.

If there was a 26<sup>th</sup> regime, EBIC believes that it should be used on a cross-border as well as on a “national” basis. Furthermore, it should be open to all banks rather than restricting it exclusively to banks operating on a pan-European basis.

At this stage, it is still too early to identify the practical areas where a 26<sup>th</sup> regime could be put into practice. It is therefore important that the application of such a regime be approached on a case by case basis.

EBIC is of the opinion that the 26<sup>th</sup> regime merits further discussion.

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<sup>8</sup> In Germany for example an interest rate is considered usurious when it exceeds the market rate by 100% at least; in Italy an interest rate is considered usurious where it exceeds the Global Effective Rate (i.e. the average rate surveyed by decree from time to time by the Economy and Finance Ministry for different sets of operations) by 50%.

<sup>9</sup> In Belgium legally enforceable caps on interest rate variation also constitute a barrier, particularly when they are accompanied by additional terms as for example those providing that the rate cannot vary higher than the contractually provided floor, which may represent a barrier in case of low market rates.

<sup>10</sup> In France, for example, mortgage credits at a fixed APR of 6.03% and variable APR of 5.52% respectively are considered “excessively high” interest rates and are thus banned as “usury”.

<sup>11</sup> In France sub-primes, i.e. loans to borrowers whose credit score is lower than required for mainstream lending, are thus rendered impossible.

What has to be noted though is that up until now the 26<sup>th</sup> regime has never been discussed with regard to contract law. EBiC underlines that a 26<sup>th</sup> regime should under no circumstances lead to confusion with the issue of product harmonisation to which the Industry is strongly opposed. Contractual terms are the main drivers for product variety and innovation. As such, product harmonisation would negatively affect product diversity and innovation, both vital features to achieve more efficient and competitive mortgage markets as defined by LE Report. It could even lead to the disappearance of a number of products. Therefore, a 26<sup>th</sup> regime is only acceptable if it does not replace existing products and contracts. It should be construed in such a way that it does not negatively affect product diversity, innovation and competition in the market.

In this context it is also important to bear in mind the specificities of mortgage credit (due to its legal nature) as well as the questions raised with respect to applicable law and the Eurohypotheec.

### **3. Conclusion**

EBiC would like to stress once again that it does appreciate the Commission's commitment to the "better regulation principle" and the open approach adopted in the Green Paper on Mortgage Credit leaving enough room for upcoming discussions in which it will continue to contribute in a constructive and positive way. With respect to the content of the Green Paper, EBiC would like to confirm that it believes that there is room for further integration of mortgage markets and benefits to be derived from it. What is however not clear, is how much room there is and whether or not there is a business case for Commission action.

Following on from what was outlined and explained above, with regard to the answer to the key question to be addressed by this Position Paper – namely whether or not there is a business case for Commission action, i.e. that the expected benefits would outweigh the anticipated costs of the regulation – EBiC believes that this point remains to be proven. Indeed, EBiC does not see London Economics' Report on the Costs and Benefits of Integration of European Mortgage Markets as sufficient evidence in itself to justify concrete policy measures.

Furthermore, it must be noted – as has been outlined above – that markets are already broadly integrated in respect of price according to the findings of the EMF/MercerOliverWyman-Study, which are now being confirmed by London Economics (cf. p. 16 seq. of LE Report). Alongside these two studies EBiC believes that the room remaining for further integration is rather small.

Were a business case to be proven, it is clear from what has been said in this Position Paper that the obstacles that need to be addressed first by the Commission are those which deter lenders from going cross-border. Therefore, it was a necessary and useful exercise carried out by the Forum Group on Mortgage Credit to identify as a first step existing obstacles, which prevent consumers and lenders from taking full advantage of the single market.

However, from a lender perspective, it is even more important to first prove that the removal of the obstacles identified would bring the purported benefits. This has not been achieved yet. Second, the different policy measures that could be adopted to achieve further integration must be evaluated individually. Only if an impact assessment carried out with regard to each one of these measures individually gives evidence that the expected benefits would outweigh the anticipated costs is Commission action justified.

Finally, EBiC looks forward to playing an active and constructive role in forthcoming discussions with the Commission and other stakeholders.

**Annex to the EBIC Position on the Commission Green Paper on Mortgage Credit in the EU and London Economics' Report on the Costs and Benefits of Integration of EU Mortgage Markets**  
**Industry Questionnaire on the Commission Green Paper on Mortgage Credit**

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## **1. Introduction**

Q31: It is clear from the Green Paper that Commission assumes that there is still considerable room for greater integration with the outcome being 'a more efficient and competitive mortgage credit market'. What is your assessment of the situation? Bearing in mind that the EMF/Mercer Oliver Wyman-study showed that national mortgage markets already are highly competitive and efficient what is your appreciation of the margin for further integration?

## **2. Obstacles to Integration: Industry Priorities**

### **2.1 Legal and Related Issues**

- **Client Credit-Worthiness/Cross-border access to national databases**

Q21: Following the same approach as for consumer credit, the Commission considers that the priority could be to ensure cross-border access to databases on a non-discriminatory basis. It welcomes comments on this. *Please comment on the approach considered by the Commission.*

- **Land and Mortgage Registers**

Q26: Before making further assessments, the Commission would welcome input on all these issues (*accurate reflection of charges in land registers, para. 44; EULIS project, para. 45; funding of such projects, para. 46*). *Please comment on para. 44 to 46 of the Green Paper and send us all the information you may have with respect to the issues raised in these paragraphs.*

- **Forced Sales Procedures**

Q24: The Commission seeks views on the following gradual approach to encourage improvements in forced sales procedures: to first collect information on the cost and duration of these procedures in all Member States and their effectiveness in protecting the interests of all involved, then present it in a regularly updated "scoreboard" and, should this prove ineffective in the long run, consider putting forward more robust measures. *Please give us your views with regard to the approach laid out by the Commission.*

- **Property Valuation**

Q22: What are the merits of a single EU standard, for both valuation processes and valuers?

Q23: What are the merits of Commission action to ensure mutual recognition of national valuation standards?

- **Applicable Law**

Q33: In para. 32 the Green Paper is giving 3 possible solutions for the questions arising from the issue of Applicable Law with regard to mortgage credit contracts (1<sup>st</sup> alternative: specific regime for the law applicable to consumer mortgage credit contracts in future regulation; 2<sup>nd</sup> alternative: freedom of choice of law; 3<sup>rd</sup> alternative: exclusion of the application to a consumer mortgage credit contract of the consumer's mandatory protection rules). Do you support one of these solutions? Please give us your views with regard to this issue.

- **Euromortgage/Eurohypothec**

Q27: The Commission invites views on the feasibility and desirability of the Euro-mortgage. It will, in any event, await the outcome of ongoing initiatives to inform its assessment of this issue. *Please give us your views with regard to the issue raised by the Commission.*

- **Tax**

Q25: The Commission seeks information on similar or other tax obstacles to the cross-border provision of mortgages, which are likely to infringe the freedoms provided for by EU law. *Please give us your views and the information you may have with regard to the issues raised by the Commission.*

## **2.2 Funding and Secondary Markets**

Q28: The Commission intends to create an ad hoc stakeholder working group to examine the need for and nature of action on the funding aspects (primary and secondary) of mortgage credit.

Q29: It is interested to assess to what extent a pan-European market in mortgage funding can be promoted by market led initiatives, e.g. on documentation standards and model definitions to be used in cross-border funding activities. *Please give us your views with regard to the issues raised by the Commission.*

Q30: In this respect, the Commission is interested to receive views on whether mortgage lending should necessarily be an activity which is restricted to credit institutions, or whether and under which conditions such activity could be performed by institutions which do not take deposits or repayable sums, and therefore do not fall within the scope of the EU definition of a credit institution and therefore of all related prudential rules. *Please give us your views with regard to the issues raised by the Commission.*

## **2.3 Consumer Protection Issues**

- **Information/Code of Conduct on Home Loans**

Q1: Should the Code of Conduct be replaced by binding legislation or remain voluntary?

Q2: What information should be given to consumers? A careful balance must be found between information deficiency and information overload.

Q3: The Commission considers it fundamental that pre-contractual information is provided at a stage that enables the consumer to shop around and compare offers. Can such a common EU stage be identified, given the variations in Member States' traditions and legislations?

Q4: Should an information provision regime apply only to lenders or to others such as brokers too? How can compliance with any such regime (binding/voluntary) be ensured?

- **Advice Provision and Credit Intermediation/Duty to advise**

Q5: Should the provision of advice to the borrower be made compulsory or be a matter of choice?

Q6: Should conditions be applied to any advice actually provided, whether under a duty or by choice (e.g. standards for the advice, sanctions for non-compliance, advance disclosure of fees, of the adviser's role and recording on durable medium)?

- **Annual Percentage Rate/Mortgage APRC**

Q10: What is the purpose of an APR? Information? Comparison? Both?

Q11: Should there be an EU standard covering both the calculation method and the costs elements?

Q12: If so, what kind of cost elements should such an EU standard include?

Q13: The Commission welcomes views on the merits of providing separately information on all costs not specified in the APR, and on the presentation of the effects of the APR in concrete terms such as the cost per month or the overall cost of the loan. *Please give us your views with regard to the issues raised by the Commission.*

- **Early Repayment**

Q7: Should early repayment be a legal right or a matter of choice? If it is to be a right, should it also be made possible for a consumer to waive this right? Under what conditions? Should this right be subject to compensation in the form of fees?

Q8: How should such fees (whether under a right or through contractual choice) be calculated? Should there be caps, as is the case in some Member States?

Q9: How should the consumer be informed about early repayment? Is there scope for consumer education here?

- **Usury Rules and Interest Rate Variation**

Q14: What are the implications of usury rules for market integration (including any relationship with products such as equity release and mortgage insurance)?

Q15: Should this issue rather be examined in a broader, non-mortgage specific, context?

Q16: Do such restrictions hinder market integration?

Q17: What impact can they have on the development of particular products such as equity release products?

- **Enforcement and redress/Alternative Dispute Resolution**

Q19: Should the Commission consider imposing on Member States an obligation to ensure the existence of such alternative means of redress in the mortgage credit area?

Q20: The Commission welcomes views on ways to reinforce the credibility of existing alternative redress systems, particularly in the mortgage credit area. *Please give us your views with regard to the issues raised by the Commission.*

## **2.4 26<sup>th</sup> regime**

- **Credit Contract**

Q18: The Commission welcomes views on the merits of the standardisation of mortgage contracts, e.g. via a 26<sup>th</sup> regime instrument. *Please give us your views with regard to the above issue.*