



EMERGING CHALLENGES IN RETAIL FINANCE AND CONSUMER POLICY

Conference

18 November 2014, Brussels



This steering note is to provide participants with background information on the topic and to stimulate questions to be addressed during the conference. It does not reflect the opinions, views or policy positions of the European Commission. Neither the European Commission nor any person acting on its behalf may be held responsible for any use of the background information contained therein.

Agenda point 3: What could be next on the EU mortgage credit agenda?

1. Brief introduction

In the wake of the financial crisis, many households ended up in negative equity due to the correction of the property markets or because of unemployment. Major problems were also reported in countries with a high exposure to consumer loans in foreign currencies. This resulted in a growing number of mortgage credit defaults. At the same time, consumers still find it difficult to access mortgage credit in another Member State. Several factors may explain this situation, including different debt recovery procedures, credit data systems. Other obstacles might include standards for property valuation, land registration systems, tax regimes, creditors' risk policies or language obstacles, which are not addressed in this steering note.

2. Why is it necessary to discuss 'what could be next on the EU mortgage credit agenda'?

Directive 2014/17/EU (the 'Mortgage Credit Directive' or 'MCD') was adopted to encourage responsible lending, ensure a high level of consumer protection and facilitate the creation of a single market for credit. Responsible lending will be fostered by EU-wide creditworthiness assessment standards and obligations to inform consumers at pre-contractual stage. The first steps towards creating a single market for mortgage credits will be built on the passport for credit intermediaries, better comparability between creditors' offers via the ESIS, non-discriminatory access to credit databases for all creditors and high-level standards on property valuation.

a) The MCD contains high-level principles on arrears and foreclosures. However these may not be enough to address the problem of households' over indebtedness, which has not only consequences for the households concerned and financial industry, but also for the overall health of the economy in terms of demand, employment and growth. The diversity of national systems and procedures, especially with regards to debt solutions schemes, may also still limit the provision of credit across borders. It appears worth assessing whether and how such high-level approach should be further complemented at Union level by additional rights and obligations, as foreseen in the review clause of the Directive.

The Commission Recommendation on a new approach to business failure and insolvency of 12 March 2014 contains a framework for preventive procedures and for second chance for business debtors, but also urges Member States to examine whether those principles would not be usefully applied also to over-indebted consumers. As indicated in Point 36 of that Recommendation, the Commission will examine this question and to provide an appropriate follow-up.

b) The MCD requires that creditors, when assessing the consumer's creditworthiness, take appropriate account of factors relevant, such as for example income, savings, assets, expenses, features of the loan on offer, but also that the information used is verified, sufficient and proportionate. Similar approaches are put forward in the Opinion of the European Banking Authority on responsible lending of June 2013¹. Such standards are expected to limit the sale of inappropriate products and thus to limit the level of over-indebtedness. This would also contribute to improve the quality of the banks' balance sheets in the long run. Competition among creditors may also be affected, thus also impacting on consumer choice and on credit costs for borrowers.

Credit databases constitute for creditors one of many possible sources of information for assessing a consumer's creditworthiness. The consultation of credit databases raises a number of sensitive questions². Some practitioners, have criticised the current availability and reliability of information contained in credit databases at cross-border level. The MCD grants creditors the option to consult a database situated in another Member State, via the principle of non-discriminatory access to databases used in Member States to assess the creditworthiness of consumers. This, it is hoped, will limit the reluctance of creditors to grant credit to people with no credit history in the country where they are applying for credit and to facilitate the distribution of mortgage credit across borders. However, if lenders fail to make sense of the data available or only have access to insufficient quantities of data, the MCD provision risks not fulfilling its purpose. The current situation may not be considered satisfactory in this respect. The collection and sharing of data techniques in Member States are very diverse currently. Certain credit registers only engage in 'negative data reporting'³,

¹<http://www.eba.europa.eu/documents/10180/604499/EBA+Opinion+on+Good+Practices+for+Responsible+Mortgage+Lending.pdf>

² For instance, some stakeholders have questioned the need to use information contained in credit databases for creditworthiness assessment purposes, the added-value of such databases or their adequacy to meet this objective.

³ Credits will only be reported upon once the consumer did not manage to meet his/her payment obligations.

whereas others also contain ‘positive data’⁴. In addition, the definitions used to assess which data should be entered into the registers differ from one country to another. The legal form of credit registers varies across Member States, as well as the obligation or not for lenders to consult the credit database and the rules on data sharing. According to the 2012 ACCIS survey⁵, regulatory differences may explain the limited volume of cross-border sharing of data⁶. In this context further work on credit registers may be warranted.

3. Issues and aspects of the topic to be addressed during discussions

Preventing, limiting or addressing consumers’ defaults on mortgage credit

The different options available to address situations where the borrower enters into financial difficulties should be discussed:

(i) Further responsible lending measures. As shown in the FinCoNet report on responsible lending⁷ of July 2014, a broad range of measures (e.g. detailed rules for creditworthiness assessment, suitability tests, limitations on certain product features) and supervisory tools for monitoring and enforcing compliance exist internationally. Would additional responsible lending measures to the MCD be required and which areas would deserve particular attention inside the EU? Should better enforcement of existing rules be sought after? Should supervisory tools be further developed?

(ii) Guidance to creditors for early detection of financial distress, reasonable forbearance and debt reorganisation. Some Member States, e.g. Ireland, the United Kingdom or Portugal have implemented principles or rules to ensure that lenders effectively identify borrowers at risk of defaulting and try to find arrangements with them at an early stage. The European Banking Authority also issued an opinion⁸ in June 2013 identifying best practices. The discussion should enable to identify best practices and the right setting for dealing with financial distress, reasonable forbearance and debt reorganisation. Are certain arrangements (e.g. change in contract terms, level of interest rates, types of credit) preferable compared to others?

(iii) Principles for institutional debt solutions. The London Economics’ study on means to protect consumers in financial difficulty⁹ of December 2012 presented a typology of debt solutions aiming at granting the borrower in payment difficulties a fresh start by re-organising, reducing or cancelling the debt value. What would be the best practice model for each of these debt mechanisms in cases of mortgage default - debt reorganisation, debt relief, debt cancellation? The following aspects should also be discussed in the context of mortgage debt: the desirable eligibility criteria, the rules of procedures for the responsible body

⁴ Every single credit is registered. Data on other types of commitments may also be reported.

⁵ http://www.accis.eu/fileadmin/filestore/newsflash/50923786_2_UKMATTERS_accis_2012_survey_of_members.pdf

⁶ Another possible reason mentioned in the report is that lenders might have little appetite for sharing data in the belief that it might impact their competitive advantage on a given market.

⁷ <http://www.finconet.org/FinCoNet-Responsible-Lending-2014.pdf>

⁸ <http://www.eba.europa.eu/documents/10180/604521/EBA+Opinion+on+Good+Practices+for+Borrowers+in+Payment+Difficulties.pdf>

⁹ http://ec.europa.eu/internal_market/finances-retail/docs/fsug/papers/debt_solutions_report_en.pdf

(including whether there should be a formal out-of-court procedure), the concrete arrangements available and the consequences under the scheme, how to ensure the process is efficient and to allow a fresh start for the borrower – keeping in mind that mortgage debt is not the only type of debt that consumers' default on.

It might be useful to recall that the study also examined another debt settlement model ('datio in solutum'), which enables borrowers to get rid of all debt by handing back the property. Proponents usually claim that this helped re-energise the economy in the United States since consumers were rapidly able to consume again. On the other hand, opponents consider that this undermines the classical lender/borrower relationship and could lead to higher interest rates.

Principles on credit registers

The creditor should verify the prospect of the consumer to meet his obligation under the credit agreement on the basis of information from relevant internal or external sources. To some degree, the data from credit reporting can corroborate the data gathered by the creditor. When credit databases are used, it should be ensured not only that the data included is accurate, but also clear, timely and understandable.

(i) The discussion should allow to identify, the scope of data that could be of use to foreign lenders for their creditworthiness analysis and best practice modalities to make this data available. Options include the definition of a common minimum set of data to be reported to the credit registers and made available to creditors (e.g. data on defaults); development of mechanism(s) to facilitate data sharing (e.g. memorandum of understanding¹⁰, bi/multilateral agreements, online portal); the possibility for individuals to 'carry' their own data with them when seeking credit abroad; an identification number for borrowers; or a public information source on credit registers in the Union. As regards cross-border access to databases, should in your opinion a particular model¹¹ be encouraged?

(ii) Practical solutions to help lenders better understand foreign credit reports should be discussed. Would it, in particular, be helpful to seek greater convergence¹² or harmonisation of the key terms used to determine data being reported and processed (such as 'defaults', 'arrear', 'loan types, etc), credit registration criteria (e.g. registration thresholds); data processing conditions (e.g. update frequency, retention periods)? Which actions would you consider necessary to guarantee the success of such an initiative?

(iii) According to the MCD, the European Commission will have to examine by 2019 whether credit registers operating in Member States require supervision. In light of this, it

¹⁰ A MoU already exists between several credit registers in the Union:

<https://www.ecb.europa.eu/pub/pdf/other/memoxinccreditregisters201004en.pdf>

¹¹ Four possible models were identified in the Expert Group on Credit Histories (EGCH) report in 2009: direct access, indirect access, report portability, right of access.

http://ec.europa.eu/internal_market/consultations/docs/2009/credit_histories/egch_report_en.pdf

¹² The EGCH recommended further working towards the convergence of concepts and definitions used. This opinion was shared by a majority of respondents to the public consultation organised on the report.

might already be useful to examine more closely data protection issues, security aspects, quality and usefulness of the data reported.

4. Potential challenges - policy making and choice of the most effective policy approach

Encouraging responsible lending (including via the proportionate and appropriate usage of credit databases) and reducing situations where consumers find themselves unable to meet their credit obligations, may be justified not only on consumer protection grounds, but also for single market, economic efficiency and financial stability reasons.

However, the wide diversity of existing national systems and rules (e.g. on civil law, procedural aspects including the range of procedures available, institutional structures, rules on data sharing), the differences in market conditions, credit cultures and problems in Member States as well as the sensitiveness of the issues in terms of consumer protection may pose additional challenges for policy action. Any initiative should weigh the intended benefits against the possible costs and risks associated with a particular action and find the right balance between lenders' and consumers' rights and duties. The pros and cons of standardisation vs. a step-by-step approach should be carefully assessed; the principles of subsidiarity and proportionality should also be respected.

Regarding post-contractual issues, while 'moral hazard' in relation to credit defaults demands attention, policy measures should also have regard to a wider range of economic, social, institutional, individual and cultural factors that may lead to credit defaults. An important challenge is to determine at which stage of the credit default process Union action, if any, would be most effective. The scope of action should also be carefully defined: encouraging best practices, setting minimum standards for preventive restructuring frameworks¹³, imposing measures on some elements of the restructuring or debt cancellation process, or following a more holistic approach? While mortgage debt is a serious problem, especially in some countries, this is not the only type of debt that consumers default on. In this respect, issues such as the procedures available to consumers who need to restructure, reduce or cancel their debts might need to be addressed whilst not only bearing internal market and consumer protection considerations in mind, but also the principles of access to justice and effective remedies. Appropriate instruments to meet these objectives would also need to be carefully evaluated.

As regards cross-border credit reporting, any policy action would need to be adequate to the needs of creditworthiness analysis, technically feasible and practical. In addition, facilitating cross-border credit data transfers requires clear rules with regard to consumer protection and for the protection of personal data¹⁴. EU data protection rules aim to protect the fundamental rights and freedoms of natural persons, and in particular the right to personal data protection, as well as the free flow of such data. The processing of personal data on individuals (e.g. unlawful disclosure to third parties, or collection for unlawful purposes) is risky. The quality

¹³ See for instance Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500 final.

¹⁴ This has been highlighted in several reports, see for instance EGCH report or CEPS-ECRI task force report <http://www.ceps.be/book/towards-better-use-credit-reporting-europe>.

of data is crucial, as inaccuracies can result in unjustified loan denials, higher borrowing costs, and potential exclusion if inaccurate data is shared across different industry segments. Concerns are even higher in a cross-border context as it may be more difficult to trace transmissions, rectify errors or outdated information or because of stronger data holder identification problems (e.g. in the event of homonymy) or differences in interpreting the rules on consumer's consent. Any initiative to facilitate cross-border access to credit databases would have to comply with the existing EU legislation in the field of data protection. The Data Protection Directive 1995/46/EC harmonises the national data protection rules, and lays down, inter alia, the criteria for rendering data processing legitimate, the data subject's rights, including that of being informed on the processing and of access to his or her personal data, and on monitoring by independent data protection supervisory authorities (DPAs). Member States have implemented the 1995 rules differently, resulting in divergences in enforcement. The Commission's 2012 proposals for data protection reform¹⁵ update and modernise the principles enshrined in the 1995 Directive to guarantee privacy rights in the future. In particular, the proposal for a General Data Protection Regulation will provide a single set of rules on data protection, valid across the Union, and create the conditions for swift and efficient cooperation between DPAs, including setting up a consistency mechanism at Union level, to ensure that DPAs' decisions that have a wider European impact take full account of the views of other DPAs concerned, and are fully in compliance with Union law. The proposal is however currently under negotiations between the European Parliament and the Council.

5. List of possible questions for the discussion

Principles to prevent, limit or address consumers' defaults on mortgage credit

1. Do you consider the requirements of the MCD are sufficient to ensure responsible lending in practice? If not, what further preventive measures or supervisory tools could be desirable?
2. Should creditors be further guided in exercising forbearance? What would be best practices and prerequisites for success? Should some arrangements be preferred to others?
3. Do you see a need for encouraging at Union level the development of debt solutions at national level? If so, which ones (debt reorganisation, debt relief, debt cancellation)?
4. If further action is needed, which issues should be specifically addressed (e.g. eligibility criteria, responsible body, principles for its action, length of procedure, efficiency, etc)?
5. What measures are likely to allow consumers a fresh start (e.g. limiting the discharge time, type and length of constraints on the consumer declared bankrupt e.g. information on a database)?
6. Do you consider 'datio in solutum'(i.e. return of the property to get rid of debt) a viable debt solution option (from a consumers' perspective/ lenders' perspective)?

¹⁵ http://ec.europa.eu/justice/newsroom/data-protection/news/120125_en.htm

7. What policy approach or policy mix would be desirable to tackle the issue of consumers not being able or no longer being able to meet their mortgage credit commitments? (Responsible lending, creditor's action, debt solutions, ...). Do such potential approaches need to go beyond mortgage lending related issues (e.g. encompass rent arrangements and other consumer credit)?
8. Should an approach similar to Recommendation C(2014)1500 on business failure be followed at consumer level, as recommended in Recital (15) of that Recommendation?

Principles on credit registers

9. To which extent, can information contained in credit databases contribute to creditworthiness assessments and can credit histories help assess the prospect of the borrower to meet his obligations in the future? From a lender's perspective/consumer's perspective, is it recommended to consult such databases before granting a credit? If so, what should be the appropriate, necessary safeguards (e.g. in terms of adequacy to the objective, consumers' rights and privacy)?
10. Does the consultation of credit databases in your view contribute to, help to prevent over-indebtedness and support fair access to credit and financial inclusion? If yes, in which way?
11. If the exchange of credit data is actually considered useful for assessing creditworthiness, what steps would need to be taken to ease credit data exchanges cross-border, if any?
12. Do you foresee problems in the long run with possibly asymmetric data reporting across borders? If so, which type of data sharing should constitute the minimum basis for cross-border reporting?
13. Would the 'standardisation' of certain concepts at Union level contribute to help lenders to better understand foreign credit reports and contribute to better credit decisions? If so, for which terms, registration criteria and processing conditions convergence should be sought for?
14. What action if any would be needed to ensure secure and high quality data in credit registers whilst safeguarding a high level of consumer protection when it comes to the handling and sharing of such data? Do you think problems, if any, currently arise from a regulatory issue (e.g. lack of rules, unclear rules, existing gaps, etc.) or an enforcement issue (e.g. in terms of competencies, resources, coordination of competent authorities, complaint mechanisms for consumers, etc.)?
15. Do you see a need to supervise credit registers at Union level? If so, which would be the most important aspects to supervise? What supervision approach and control mechanisms would you suggest?