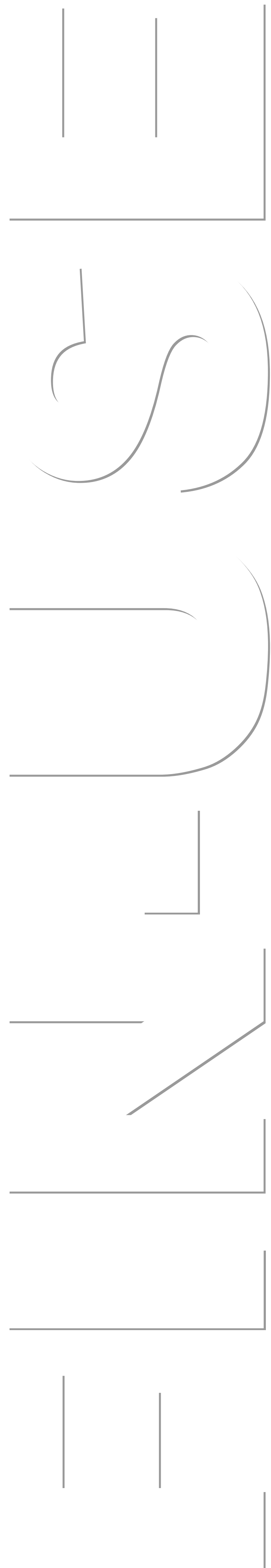

FIN-USE

EXPERT FORUM OF FINANCIAL SERVICES USERS

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OPINION ON THE EUROPEAN COMMISSION'S GREEN PAPER "MORTGAGE CREDIT IN THE EU"

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EXECUTIVE SUMMARY

1. Taking-out a mortgage is for most European consumers the most important financial decision of their lives; mortgage debt is the main liability held by consumers and repayments constitute the single most important outgoing.

2. FIN-USE welcomes the Green Paper approach to a subject with a truly huge social and human dimension.

3. National and European consumer organisations have for many years consistently called for EU legislation in this area. In contrast, only consumer credits (for lesser amounts and shorter periods) have been regulated.

4. Today consumers do not want to contract cross-border with foreign lenders. To move towards an integrated market, those lenders therefore have to access consumers in their home market if consumers are to have a greater choice and access to a range of different offers, with the chance of lower prices and spreads.

5. Because of this, FIN-USE today is not calling for a complete regulation. Instead, regulation should be considered on a step-by-step basis and in some areas on a minimum harmonisation basis.

6. After the excellent work of the Forum Group, it would be a good idea to work on specific problems like early repayment, consumer information and APR in a specialised working group with experts from the consumer and the industry side.

7. The Green Paper does not set out its view of what integration really is; it just seemed to argue that national markets must ease business for lenders. The objective of an integration of EU mortgage markets should not disregard the fact that in a near future national markets will still exist and prevail.

8. Objectives for action on a European level should be diverse: not only integration of the mortgage markets, but also concrete fostering of competition by means of consumer protection (greater transparency and comparability) and making cross-border access easier for lenders.

9. FIN-USE believes that the report of London Economics on the costs and benefits of integrating EU mortgage markets is over-optimistic in its views on GDP growth.

10. What is needed is a careful, thorough consideration of the issue and not a hasty snap judgement. Regulation can help, but clearly not regulation alone as the developments must also be market driven. As to regulation full harmonisation methods do not sufficiently take into account the different national situations concerning competition, product preferences and the behaviour of consumers and credit institutions. Codes of conducts do not help as they are a fig leaf for

the industry, especially poor quality lenders, and can only be effective under very specific conditions.

11. The wide range of topics addressed in the Forum Group Report cannot be tackled at the same time. Thus FIN-USE recommends proceeding step by step.

12. *Consumer Protection*

    a. As consumer confidence is vital in such big markets as the mortgage markets FIN-USE believes that in the area of consumer protection some binding regulation is needed: on APR, on the availability of early repayment, the fairness of early repayment fees and variable interest rate variation and the circumstances when lenders can terminate loans and repossess homes.

    b. The Voluntary Code of Conduct on Pre-Contractual Information for Home Loans of March 2001 has failed and must be replaced by binding legislation.

    c. There should also be binding harmonisation of the Annual Percentage Rate of Charge (APRC). If this definition is restricted to costs levied by the lender then all other costs associated with the contract must be presented prominently and in an easily understandable way.

    d. If lenders or intermediaries give advice on consumers this must reflect their real demands and needs. The benefits of such an approach would include reduced rates of default, repossession and over-indebtedness.

    e. FIN-USE considers that an early repayment option is very important for consumers. Information on early repayment and its costs must be regarded as one of the essential points of the intended contract.

    f. Early repayment fees represent a strong barrier to consumer mobility, competition and market integration and must be restricted to the clear cost (damage) they entail for lenders.

    g. There should be rules for the adjustment of variable interest rates.

    h. National usury Rules are important and should not be abolished when liberalising national markets.

    i. Effective Enforcement and Redress is important; redress systems which are independent of industry should be encouraged and facilitated.

13. *Legal Issues*

    a. Applicable Law: FIN-USE favours the status quo as for mortgage credit contracts (Rome Convention) and for the law applying to the collateral.

b. Client Credit-worthiness: As the data collected is of an extremely sensitive nature not only access for foreign lenders must be an issue but also effective rules protecting data privacy and ensuring accuracy, including special regulations concerning faulty entries into the database.

c. Property Valuation: The Commission should ensure that EU-wide valuation standards are acknowledged, at least concerning the basis of evaluation and experts' qualifications.

d. Forced Sales Procedures: A harmonisation of national laws seems very unlikely in the near future, but the Commission could as a first step collect and analyse national schemes.

e. Tax: FIN-USE believes that the Commission should investigate and address tax distortions for all parties.

1 ASSESSING THE CASE FOR COMMISSION ACTION

Given the amount of money and the long time periods involved, taking-out a mortgage is for most European consumers the most important financial decision of their lives. Moreover, as a result of increasing property prices, mortgages involve ever-larger amounts of money and ever-longer periods of time, with mortgage repayments constituting the single most important outgoing during most European consumers' working lives.

Moreover, mortgage credit markets are, as rightly highlighted by the Commission Green Paper, amongst the most complex markets in which consumers engage.

FIN-USE fully recognises that mortgage lenders are businesses that, in order to be competitive, must be as efficient and effective as possible in their approach to housing credit. Nevertheless, FIN-USE welcomes the Green Paper's approach to a subject with a truly huge social and human dimension.

While lenders are valid stakeholders in any debate about housing credit, the same is true of consumers, since without consumers, there would be no market for housing credit.

FIN-USE recalls that national and European consumer organisations have for many years consistently called for EU legislation to protect consumers when they take-out mortgages on a cross-border basis. Paradoxically, consumer credits (for lesser amounts and shorter periods) have been regulated since 1990 via the Consumer Credit Directive. Indeed, the need to legislate on cross-border mortgages is evidenced by the fact that some Member States transposed the CCD in such a way that it also covers mortgages. This has however resulted in a situation where there are now quite different levels of consumer protection across the Member States.

FIN-USE notes that the Report by London Economics on the Costs and Benefits of integrating EU Mortgage Markets finds that full integration of EU mortgage markets would be of net benefit to the EU, and that consumers in particular would benefit through the role of more flexible mortgage products in allowing them to schedule their consumption more smoothly over time.

FIN-USE therefore welcomes this Green Paper. However, if its objective is to create a European mortgage market, then consumers across the EU must feel comfortable with comparing offers from, and in turn transacting with, mortgage lenders from other Member States. That scenario may develop some time in the future. For now however, integration of the market will instead involve other routes, with foreign lenders seeking to establish a presence on other markets, and thereby increasing the range of products available and competition between providers. The result should be markets with more diverse products, of better quality and better price, with much greater competition among suppliers.

2 CONSUMER PROTECTION

2.1 Information

FIN-USE strongly believes that the Voluntary Code of Conduct on Pre-Contractual Information for Home Loans March 2001 must be replaced by binding legislation. The independent analysis of the Code in 2003, two years after its supposed implementation, provided clear evidence that it had failed, with only approximately half of the mortgage lenders across the EU applying the Code, and of those a maximum of 6.5% providing the standard pre-contractual information required. Even if the Commission were to analyse the application of the Code of Conduct once again - as seems to be the case now – from our knowledge of consumer experiences we think that the results will not be much different.

FIN-USE's view is that stringent criteria have to be met if self-regulation such as codes of conduct are to work well. These are in brief:-

- A good code of practice
- Independent governance
- Full coverage of the industry
- Adequate resources
- Effective monitoring
- Enforcement powers and sanctions
- Regular review process
- Support of key stakeholders.

The Code of Conduct falls so far short of these criteria in almost every respect that the only conclusion that can be reasonable reached is that the Code is beyond being made to work effectively, and therefore legislation is necessary.

The necessary legislation can – in a first step – be dealt with on a national level supported by a EU framework regulation on a minimum harmonisation basis.

As information provision is a crucial issue in mortgage transactions, FIN-USE believes that such information must be harmonized at a high level of consumer protection. Consumers must be provided with an appropriate and balanced level of information necessary to allow them take an informed decision, in a manner and at a time when such information provision is most effective. In this context, FIN-USE finds that the aforementioned European Code of Conduct already sets some EU-wide precedents for standardized pre-contractual information, both in terms of content and format. However, this information must also include information about the method of calculation of the nominal interest rate, an explanation of the equivalent effective rate, and also information about the total cost of credit.

FIN-USE would call on the Commission to launch a study to ascertain the information needed by consumers in order to allow them easily and correctly access

and in turn compare competing mortgage offers, while bearing in mind that consumers cannot be expected to be experts on increasingly complex mortgage products.

FIN-USE agrees with the Commission assertion that it is fundamental that pre-contractual information be provided at a stage that enables consumers to shop around and compare offers. While FIN-USE also acknowledges that there are different traditions and legislations in the various Member States, it should nonetheless be clear that pre-contractual information is precisely that – ex ante information which is provided before the consumer and lender enter into a contract and which is therefore non-binding. Indeed, pre-contractual information should be provided sufficiently in advance of any signing of a contract in order to allow the consumer sufficient time to reflect on what is after all most likely to be the single most important (financial) decision of his/her life. Indeed, the lack of a cooling-off period when buying a house in some Member States means that it is even more important that consumers be provided with, and understand, pre-contractual information. An additional reason for replacing the Code of Conduct with binding legislation is its lack of definition of the key term "pre-contractual".

FIN-USE also believes that the consumer should be entitled to certain minimum levels of information after the entry into force of the contact such as advance warning of interest rate changes (in the case of variable interest rate mortgages),

FIN-USE believes that the aforementioned principles underpinning a high, common level of consumer protection must apply irrespective of whether the consumer transacts directly with a mortgage lender or an intermediary. Codification via binding legislation would greatly facilitate compliance with such an information regime.

2.2 Advice Provision & Credit Intermediaries

FIN-USE believes that the provision of advice to borrowers cannot be made compulsory as consumer needs are very different as is their knowledge. However, if advice is given by lenders or intermediaries, it must meet professional standards and reflect the real demands and needs of consumers. Any advice that fails to take account of the consumer's situation should be considered flawed. Demands and needs should be assessed on the basis of what the consumer has communicated to the advisor; merely posing a long list of questions from a standard questionnaire cannot be considered to be a well thought-out, balanced assessment. Rather, there should be clear standards for such advice, in addition to advance disclosure of any fees levied.

Concerning the activities of brokers and intermediaries FIN-USE believes that the rules applying to insurance intermediaries laid down in the Insurance Intermediaries Directive would serve as a good basis for regulating mortgage brokers and intermediaries and that information obligations need not only to apply on credit institutions, but also to brokers and intermediaries.

The benefits of such an approach, extending conduct of business rules to intermediaries no matter what financial services they are selling, would include reduced rates of default, repossession and overindebtedness.

2.3 Early Repayment

FIN-USE considers that an early repayment option is very important for consumers.

The right of early termination should not be subject to compensation in the form of fees. The bank is however entitled to ask for compensation for the damage it suffers due to the early termination of the contract. The bank might be damaged since it is possible that it can only conclude a credit contract on an interest rate lower than the one of the credit which is early repaid. On the other hand, it might be that the bank can sell the early repaid money to a higher interest rate; in this case it is only fair that the bank has to pay compensation to the borrower who paid back early.

FIN-USE does not ask for capping early redemption fees, but regards it highly important that the fee calculation method is fair and must only reflect the real damage of the bank less all saved expenses.

Concerning variable interest rate credits FIN-USE believes early repayment fees are not justified (most banks accept this).

In general, FIN-USE finds early repayment fees represent a strong barrier to consumer mobility and therefore competition and market integration and must, for this reason, be restricted to the clear cost (damage) they entail for lenders.

Information about early repayment must be regarded as one of the essential points of the intended contract. It should be provided pre-contractually, be clear, and allow the consumer to understand the importance that early repayment might have in the future for him as well its economic consequences. As such, the consumer right to early repayment should be a key element of any consumer education/empowerment programme, backed-up in turn by clear, standard, easy-to-compare information provided by lenders at a pre-contractual stage. But equally importantly, clear and comprehensive information must be provided to customers who are considering early repayment about the costs that they will face if they do repay early.

More specifically, FIN-USE proposes that the Commission carries out an independent study of the true cost of early mortgage repayment for lenders; the study should also take account of growing trends in mortgage markets.

The right of lenders to terminate mortgage contracts is an issue which FIN-USE believes must be balanced against the economic importance of mortgages to consumers; FIN-USE therefore favours restrictions on lenders' ability to terminate contracts. Consumers must also be fully and clearly informed of the circumstances allowing lenders to terminate mortgages as part of the pre-contractual information. In cases of a brief shortfall in repayments, a preliminary termination should be restricted.

Indeed, such preliminary cancellations would lead to consumer insolvency and over-indebtedness, without assisting in reclaiming the outstanding loan amount. An example of good consumer protection in this area is the Swedish Credit Act, whereby a lender is only entitled to early termination of a mortgage if it is foreseen in the contract, and if the consumer defaults on repayments for an extensive period, substantially detracts from the collateral or fails to make payment. In addition, the consumer must be allowed at least four weeks to pay off the outstanding balance.

2.4 Annual Percentage Rate

As the Green Paper states, APR is a key factor of the mortgage loan, as it also is for any type of loan. The APR determines – together with other cost factors currently not included in the APR - the "price" of the product. This is why its purpose is both information and comparison, as it is for any product.

FIN-USE believes there should be an EU standard, covering both the calculation method and the cost elements, including not only all costs arising for the lender, but also all associated charges, taxes etc. for the consumer, and in a harmonized manner (in many Member States for example, mortgage insurance is compulsory). Only in this way the APRC will serve its objective of providing a true, comparable cost to consumers. It should therefore better be named "Annual Percentage Rate of Charge" and not simply Annual Percentage Rate.

The APRC should figure in all commercial communications and advertising of the lender, as well as all documents given to the consumer at a pre-contractual stage and during the operation of the credit agreement. In cases where it is not possible to advertise one APRC because borrowers get very different APRCs according to their credit-worthiness – only an APRC can be advertised that is accessible to a majority of borrowers (see the regulation in the UK for consumer credits: the APR must be accessible to two third of the consumers).

FIN-USE considers that providing the consumer with separate information on the APR and on the costs not covered by the APR only risks leading to confusion, since it is not clear and easily understood by the consumer what the true "price" of the product is. But of course it would be a step forward to present the APR together with all the other cost elements in a kind of "cost box" as today this cost information is often scattered to the four winds, that is over the whole pre-contractual information and the contract.

Moreover, FIN-USE believes that the Annual Percentage Rate of Charge in consumer credits and in mortgage credits should be regulated in the same way; in its view, there is no reason why they should be regulated differently.

2.5 Usury Rules & Interest Rate Caps

Legally enforceable caps on interest rates are an example of the recognition by Member States of the indissociable social and human aspects of mortgage (and consumer) credits; they reflect the prevailing social circumstances in Member States and aim at protecting consumers from extortionate interest rates when seeking to fulfil one of the most important and basic human needs, namely the purchase of a home. That is why FIN-USE believes they should not be removed.

Given the aforementioned social and human aspect, FIN-USE agrees that usury rules should be examined in a broader, non-mortgage context that includes *inter alia* other consumer credits.

FIN-USE does not believe that interest rate caps impede market integration; only bad lenders try to make a profit out of interest rate terms that discriminate and harm borrowers. Usury rules help to support a market standard.

However, as national markets still are very different and will stay for quite a long time it doesn't seem the task of the EU to tackle this problem in a full harmonisation manner but to leave it to the Member States, many of which have in place efficient legislation or jurisdiction.

2.6 Interest Rate Variation

In the case of mortgage credit contracts with variable interest rates, alterations of interest rate may only be allowed be if they are:

- justified by increased loan costs for the creditor or other increase of costs which the creditor could not reasonably have foreseen when the agreement was entered, or
- based on a clearly-defined index (tracker mortgage) which can easily be checked and calculated by the consumer.

Such restrictions – which should clearly be presented in the pre-contractual information and the contract – would prevent credit institutions from adjusting interest rates to the disadvantage of consumers in a high handed and non transparent fashion. This has been observed at least in those countries where there is no strong competition in variable rate mortgages. Changes must not be discretionary and must be monitored by the national supervision authorities.

On the more specific question of interest rate variation caps, FIN-USE believes it must be clearly defined how much – in the case of a tracker mortgage – the index must change in order to qualify for an alteration of the interest rate.

The date when any alterations may take effect must be clearly stipulated in the credit contract. Such measures would help ensure clear comparability of products and legal certainty.

2.7 Credit Contract

On the 26th regime, the green paper does not go into any sort of detail about what is involved. So for example, does it extend to prudential supervision as well as conduct of business regulation? Which companies can access it, only companies that operate cross-border in some sense or any domestic company? Would there be a new 26th regulator?

Even if a unified regime offers interesting potential from a cross-border perspective two questions arise immediate concern; the scope for widespread and growing consumer confusion, the danger that a uniform code would pose to the widely differing circumstances across the market of the union.

A fundamental weakness that makes the developing of a new regime even more complex is the dramatic absence of evidence about how consumers in different Member States fare when they enter the retail market. There is evidence about costs etc from firms showing compliance costs meeting regulation but nothing on the scale of problems and detriment that consumers face. In the absence of empirical research, it is not surprising that reports, such as for example the Mortgage Forum Report, tend to be "wish lists" from industry and consumers.

2.8 Enforcement & Redress

FIN-USE believes that Member States must be obliged to ensure the existence of independent, inexpensive, properly resourced, user-friendly and effective Alternative Dispute Resolution (ADR) and redress procedures, as the costs and time involved in seeking redress through the Courts can often deter consumers from taking actions to enforce their rights. The existence of such schemes would not only benefit consumers, but also act as a deterrent to unscrupulous lenders, while at the same time encouraging bona fide lenders. Indeed, experience with such schemes in different countries demonstrates that one of the best ways to deter unscrupulous lenders, while also encouraging good lenders, is to publicly "name and shame" guilty parties (e.g., Ireland).

In addition to the aforementioned aspects, FIN-USE agrees that there is a need for a definition of cross-border lending so as to monitor lending that falls within its scope.

Ombudsman systems work better in some countries than in others. As consumer confidence plays an important role and as the resolution scheme should be as independent as can be, the European Recommendation on ADR should be followed in all cases. This means that FIN-NET membership should be reconsidered. In some countries, only industry-controlled ombudsman schemes are included. It would be preferable that the setting up of industry-independent dispute resolution schemes is encouraged and facilitated.

3 LEGAL ISSUES

3.1 Applicable Law

FIN-USE supports mortgage credit contracts continuing to be subject to the general principles of the Rome Convention and thus subject to the mandatory rules of the consumer's country of residence (Article 5, par. 2).

As for the law applying to the collateral, here FIN-USE would also favour the status quo, i.e., application of the law of the country where the property is situated.

3.2 Client Credit-worthiness

FIN-USE agrees with the Commission that there are merits in a consistent approach to the rules applying to access to databases for both mortgage and consumer credits. While FIN-USE recognizes that databases are useful for lenders, they are nonetheless a sensitive issue for consumers.

As the data collected is of an extremely sensitive nature, effective rules protecting data privacy and accuracy must be implemented, including special regulations concerning faulty entries into the database. National data security policies do not suffice if the data is to be passed to all Member States. It is not sufficient to merely define a strict set of legal uses. It is necessary to implement effective rules to correct entries as well as to establish rights to damages due to faulty entries and to ensure that corrections will be passed to all relevant institutions, including those in other Member States. Faulty entries can affect everyone. An effective protection against these types of abuse of databases is needed.

FIN-USE believes it would be necessary to independently supervise these databases, including who should have access to the data , which criteria must be met before data are communicated and what information (and when) a registered consumer should be entitled to access. Data about individual consumers should be communicable to a third party only for legitimate reasons, e.g., a creditworthiness scoring. The individual concerned should also receive a copy of the information communicated and its result concerning his credit-worthiness and be informed of how to correct any incorrect data. It would also be desirable that different databases use the same definitions and parameters when determining different levels of payment neglect, and apply the same maximum periods for data storage, after which the data must be destroyed.

3.3 Property Valuation

FIN-USE agrees that the Commission should ensure that EU-wide valuation standards are introduced as to the basis of valuation and also experts' qualifications. Such a move would serve to ensure both compatibility and comparability. A single EU-wide

standard (as opposed to mutual recognition of all the existing national valuation standards) would also be easier for consumers.

3.4 Forced Sales Procedures

FIN-USE notes that in the case of home loans, the pledged collateral is of great importance for consumers (and their families) e.g., the title deeds to the family home. Pre- and contractual information should clearly stipulate the circumstances allowing such collateral to be enforced by the lender, as re-possession of the family home is probably the most emotive aspect of mortgages credits.

As it will not be possible in the immediate future to harmonise the direct and indirect law of forced sales procedures throughout Europe or introducing a 26th regime, which completely ousts national regimes, the Commission should in a first step collect and analyse data about the procedures and procedural law within the EU.

3.5 Tax

FIN-USE agrees with the Recommendation that the Commission should investigate and address tax distortions, in order to ensure the removal of differences in fiscal treatment between local and foreign lenders. However, FIN-USE believes that the Commission should go further and work towards ensuring that all consumers in a given Member State are entitled to the same fiscal treatment, irrespective of the Member State where the mortgaged property or collateral is located, or the Member State where the lender is based.

4 MORTGAGE COLLATERAL

4.1 Land Registers

FIN-USE agrees that the Commission should continue to provide financial support to the EULIS initiative, to enable and encourage its expansion across the EU.

4.2 Euromortgage

FIN-USE would support the Recommendation to explore the concept of the Euromortgage (26th regime) in the context of its impact on the *lex rei sitae* and its rulings in detail, for example by way of an independent study, to assess its potential to promote EU mortgage market integration.

5 FUNDING OF MORTGAGE CREDIT

FIN-USE supports the Commission proposal to create an ad hoc stakeholder working group to examine the need for and nature of action on the funding aspects of mortgage credit.

On the question of whether mortgage lending should be restricted to credit institutions, FIN-USE believes that the provision of mortgage credits from non-credit institutions would serve to improve competition, thus improving choice and price for consumers. However, mortgages provided by such institutions must be regulated in the same manner as mortgages provided by credit institutions.

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