

Green Paper on Mortgage Credit in the EU
ABN AMRO Response
28/11/2005

ABN AMRO welcomes the opportunity to comment on the Commission's Green Paper on the EU residential mortgage credit markets ('Green Paper').

As a financial institution with operations in almost all EU Member States fully supporting the integration of mortgage credit, the Green Paper is highly relevant for us. This will bring concrete benefits, new perspectives as well as long-term opportunities to both consumers and lenders.

Mortgage credit is without doubt the biggest financial commitment for EU citizens. Growing constantly, the EU mortgage credits are key for the development of the economy in the EU. However, mortgage markets flourish mainly on a national level. From the cross-border perspective, those markets remain fragmented. Various legal, economical and other obstacles for both consumers and particularly lenders acting cross border create barriers preventing mortgage markets to further expand.

Therefore, we totally support the Commission's Green Paper seeking to identify to the fullest extent possible those existing obstacles. We fully welcome the Commission's careful approach as explained in the Green Paper with regard to the consultation and preliminary impact assessment. We also appreciate the Commission's commitment to consider any action after the consultation process only if it is demonstrated that there is a clear business case for the Commission's intervention in the EU residential mortgage credit markets, i.e., if the potential benefits of intervention can outweigh the anticipated costs of such intervention.

We hope that our comments presented below will contribute to the process initiated by the Commission.

I. GENERAL COMMENTS

- The Green Paper mainly focuses on the retail and consumer protection issues. We support the definition of high EU standards for consumers designed to facilitate their access to mortgage products offered by lenders from other Member States. It is indeed primordial for building the single market for mortgage credit. However, the cross-border integration of mortgage credit in the EU will above all depend on making easier for market participants to offer mortgages in other Member States. This is supported by the fact that consumers will mostly address themselves to foreign mortgage providers if the latter are present in their own country, especially since most consumers still want to have face-to-face contact when discussing and entering into a mortgage credit. In consequence, consumers' access to cross-border mortgage markets is conditioned to a large extent by the removal of the obstacles regarding lenders' ability to go cross-border.

We find that harmonisation of consumer protection rules is primordial for the integration of the mortgage markets in the EU. However, the Commission should also explore how to **simplify the cross-border activity of mortgages service providers**. Therefore, we invite the Commission to examine in future the following areas:

- Mortgage backed securities/covered bond business
 - Collateral management
 - Trading in mortgage backed securities/covered bonds
 - Registration of mortgages and of loans
- When considering how to further integrate and harmonise mortgage credit rules in the EU, we invite the Commission to take into account market and economical reality. Even though it is possible and desirable to harmonise the detailed rules on pre-contractual information, APR, standard mortgage contract, in other areas a detailed set of rules is not appropriate from a market reality point of view. We would like to suggest to the Commission to adopt the approach of defining a set of **high level principles** for certain areas, which will ensure a high level of investors' protection, while not interfering with the market rules. This approach would also be in line with the Commission's careful and pragmatic attitude as demonstrated in the Green Paper. Any EU binding initiative should be based on the **full harmonisation** in order to ensure that any EU Member State can not impose more severe requirements than those established at EU level. This will guarantee legal certainty to both consumers and lenders and a level playing field for lenders.

II. CONSUMER PROTECTION

1. Information

1. Should the Code of Conduct be replaced by binding legislation or remain voluntary?

- ABN AMRO Bank adhered to the Voluntary Code of Conduct on pre-contractual information for home loans on 5 September 2001. Since 22 August 2001, ABN AMRO has been effectively applying the Code. Hence, our full commitment to this voluntary agreement should not raise any doubt.

We recognize that the main quality of the Code is its flexibility. As non-binding instrument, the Code can rapidly be adapted to changes on the EU mortgage markets. Despite this positive characteristic of the Code, we think that the real benefits of a legally binding instrument would go beyond those of non-binding instrument. Therefore, we do not oppose any EU binding legislation covering areas similar to those tackled by the Code. The concrete benefits of such EU legislation can be summarised as follows:

- Currently, not all the EU credit institutions effectively implement the Code even though the mortgage credit providers are aware of the code since it received large acceptance amongst lenders' and consumers' associations. This situation creates uncertainty not only amongst consumers, but also amongst mortgage credit providers since some of them comply with the Code, while some others do not. As result, the competitors do not exercise their mortgage credit activity on equal terms.
 - In addition, unlike binding European legislation, the Code does not supersede national law. This has resulted in problems of coherence between the European Code and national law in certain Member States such as France, Spain and the UK. Consequently, if all competitors are subject to the same set of rules on pre-contractual information, it will be simpler, more efficient and secure for consumers and market players to operate cross-border.
- However, the EU binding legislation on prior (pre-contractual) information for consumers will bring real benefits if it is based on the following underlying principles:
- Common, harmonised definition of **mortgage credit and cross-border mortgage provision**. Currently, the mortgage/home loans are defined differently and do not cover the same scope. For the purpose of creating a level playing field between mortgage lenders across the EU, the common definition should be adopted.

We suggest the following draft definitions:

Mortgage Credit: *“Any loan provided to a consumer for the acquisition, rebuilding, refinancing of a residential property which is secured by a mortgage on this property.”*

Consumption mortgage credit: *“Any loan provided by a lender to a consumer which is secured by a mortgage on residential property which is extended to the consumer for reasons other than the acquisition, rebuilding, refinancing of a residential property.”*

- The potential legislation should be limited to the **residential, first mortgage**. The rationale of any EU action should be to provide access for all Europeans to fair and transparent residential mortgages to purchase their residential (first) home. This should include residential mortgages for properties that are used as first residential home. It should also include refinancing possibilities of the first loan to a

loan with different conditions. Any financing done using a residential property as collateral that is not a first residential home or the refinancing of such a loan should be excluded from EU legislation (e.g. equity release or second mortgages).

- Any potential EU legislation should be based on the principle of **maximum harmonisation**: when operating cross-border, credit institutions would like to be sure that in each Member State, the same amount of prescribed pre-contractual information for consumers is required. If minimum harmonisation is opted for, each Member State would be free to put in place more stringent requirements than those defined by the EU legislation. This would create legal uncertainty and no added value for consumers and lenders. Maximum harmonisation and a level playing field between competitors is the main condition for development of cross border provision of mortgage credit.
- The potential EU legislation should be defined under the form of high standard for consumer protection. In particular, the legislation should focus on mentioning the mandatory information items to be provided to the consumers first as general and then as personalised information at pre-contractual stage (like those listed by the Code of Conduct). It would be useful to require from lenders putting in bold those compulsory items included in the offer so that consumers can easily find them when comparing the offers. Therefore, any EU rules should focus on the **content** of the precontractual information and the **timing** (at which time of the relationship the general or specific information should be given).
- At the same time, a flexible implementation by market participants should be made possible. In particular, it should be clarified that the lender has **freedom as to the format** in which the information is given and **the order** in which each information item is provided. We do not want to be obliged to use exactly the same structure and sections as described in the Code's European Standardised Sheet Format. ESIS format of the Code can serve as example, but **not** as the only available format. Each lender should be able to choose how to structure its offer while using the same terminology and integrating the mandatory information as prescribed by law.

2. What information should be given to consumers?

We agree with the Commission that a careful balance must be found between information deficiency and information overload. Also, it would be too burdensome to provide all details at the very beginning of the relationship. Thus, we agree with the classification made by the Code between the general and personalised information to be given to the consumers as well as with the items listed.

3. Can a common pre-contractual EU stage be identified, given the variations in Member States' traditions and legislation?

The pre-contractual EU stage is the period between the first contact between the lender and the borrower and the signing of the final mortgage credit agreement reflecting acceptance by the borrower of the offer made by the lender.

We assume that the aim of the Commission's question is to know at which stage of the borrower-creditor relationship the pre-contractual information should be given.

We are of the opinion that all pre contractual information items (general and personal) should be given before the final written offer is made by the lender to the consumer. At that stage, the consumer may still use the information to make comparison between different offers. The offer from the lender is legally binding and based on a conditional approval (the borrower has to provide evidence of underlying facts such as income, property value etc.).

4. Should an information provision regime apply only to lenders or to others such as brokers too?

All the consumers should be ensured of the same level of protection whether they address themselves to a credit institution or a broker. Intermediaries/ brokers also face risks like negligence, careless advice which might lead to loss of clients' money. Therefore vis-à-vis the client, the person who is making the offer (whether it is a lender or a broker) is responsible for the total information flow to the client.

However, it should be made clear to (potential) borrowers that intermediaries are not lenders and therefore do not make the credit decision regarding the granting of the loan. Generally, all the information the intermediary is providing is on what loan best fits the borrowers profile when comparing to the different products offered by the competing lenders. In cases where a lender has provided information to the intermediary on its (the lender's) products, it is the intermediary's responsibility to provide a consumer with this (mandatory pre-contractual) information on a timely basis. In such an example the lender has no direct contact with the consumer and will only make an offer based on the request passed on to it by the intermediary and on the information submitted. During the conclusion of the credit agreement however, the lender once more needs to inform the consumer on a timely basis of any amendments which are or may be relevant to the consumer.

5. How can compliance with any such regime (binding/voluntary) be ensured?

Compliance should be ensured by national supervisory authorities.

2. Advice provision and credit intermediation

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

Firstly, we agree that the provision of advice by the lender or an intermediary to the borrower should be compulsory for the following reasons:

- Mortgage products are complex and are not bought on a regular basis.
- Mortgage contracts imply a long and high amount commitment for borrowers which for most people constitute the largest financial commitment in their life. This has a big impact on the borrowers' financial situation as a whole.
- This would prevent consumers' over-indebtedness and lenders' potential exposure to legal risks.

Secondly, we would like to stress the fact that the main consequence of mandatory advice will be giving ground to the borrower to make a complaint and the lender becoming liable. Given this serious consequence in terms of lender's liability, the term 'advice' should be clearly defined so that lenders as well as borrowers know exactly at which moment of their relationship does pre-contractual information provision actually becomes 'advice'. Thus, legal certainty is crucial here.

Therefore, the Commission should focus on a common definition of advice as well as on its quality. If this question is considered more in depth, we would like to stress that advice will exist when it is based on the borrower's strictly personal circumstances. Advice is given once the lender/intermediary has a deep insight into all relevant information on client's financial and personal situation. Therefore the advice is based on the information which should be sufficient for the lender to make an offer (income, life stage, property type, family composition, expected time in property etc.), but also on the borrower's knowledge and experience in mortgage credit.

For example, an advice should also be based on the following high level standards:

- The advice should enable the consumer to understand the consequences and risks of the choices he makes for specific product characteristics (i.e. an interest only loan will result in a full outstanding debt at the end of the term).
- The advice should also give an indication about which chosen product would best fit a borrower's profile (income, life stage, property type, family composition, expected time in property).

3. Early repayment

1. 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 a compensation in the form of fees?

Each borrower should be allowed to repay his mortgage before the mortgage term. In principle, early repayment should be a legal right for every borrower. The waving or opt out regime should also be made possible following the agreement between both of the parties and if the borrower is adequately informed about the effects of the waiver. However, one of the lender's basic rights is also to ask the borrower to pay compensation fees due to the financial loss linked to early repayment. The reduction of early repayment fees should be made possible in case of e.g. sale of the property combined with moving house of the borrower or of the borrower's death.

2. 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?

- We think that EU action should not be aimed at imposing a specific method for calculation of Early Repayment Fees, caps or their content of ERF. Different lenders in different Member States might be subject to different costs further to early repayments. Thus, from an economical point of view, it would not be appropriate to set up detailed EU rules on content and method of calculation of ERF. In this area 'room for manoeuvre' should be left.

The amount and calculation of ERF are closely linked to the funding of mortgage credit by each mortgage credit provider. The mortgage funding itself depends on each market player's commercial strategy and the amount of risk each lender accepts to take. The early repayment fees also depend on the conditions under which mortgage funding was obtained. This fee will also cover the costs supported by the bank when the latter has to lend to a new borrower the money received as repayment from the (first) borrower.

Example:

Client A has a loan of EUR 100.000 with a fixed interest for 10 years at 6%
After 5 years the client wants to prepay the whole loan.

To calculate the fee we first deduct the free amount repayment which the borrower is allowed to pay that calendar year on the basis of the lenders' terms and conditions (assume 20% = EUR 20.000).

Then we look at the then current 5 year rate (the period that the bank can lend out the money the client A is prepaying). Let's assume that the current 5 year rate (for loans with the same characteristics) is 4%, the client should pay a fee of the difference between the contract rate (6%) and the current 5 year rate 4%. The fee is calculated as the difference (2%) for the remaining period (5 years). This means that the Net Present Value (NPV) of these 60 (60= 5X12 months) remaining monthly payments is calculated. When calculating the NPV, we use the current 5 year rate as discount factor (the actual rate, here 4%).

Above is only an example of one of the calculation methods. Lenders should be able to choose another method and to use different basis for calculation if this was agreed with the client.

Instead of exploring calculation methods, caps etc. the Commission's action should focus on the definition of high level principles ensuring investors' protection. As example, we would like to propose the following standards:

- ERF are not a fine and their underlying justification is to get back the mortgage funding and compensation of financial loss, **not to make an additional profit.**
- ERF should only cover the costs supported by the lender and caused by early repayment.

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

We agree that full disclosure of fees to the consumers should be given, including early repayment fees. Borrowers should be clearly informed about any possibility, conditions and modalities of ERF. Details (why ERF are applied, what they cover, how they are calculated, conditions under which some of these charges can be refunded or at least reduced, on which products' characteristics they depend, the period during which they apply) of the ERF should be set out in the mortgage offer.

4. Annual Percentage Rate

1. What is the purpose of an APR? Information? Comparison? Both?

The purpose of APR is the overall cost for comparison. It is designed to show the yearly costs of a mortgage stated as a percentage of the loan. The figure is intended to help consumers to compare the overall cost of different loans. It also prevents lenders from advertising low rates and hiding fees, so it aims to create a level playing field between them. Since APR is a very confusing number, the consumers should be informed on what is the difference between the annual percentage rate and other interest rates.

2. Should there be an EU standard covering both the calculation method and the costs elements?

Calculation of mortgage *APRs* and the cost elements which enter into such calculations vary not only across Member States but also on a domestic level, making comparisons between different offers more difficult. Also, coexistence of different *APRs* standards with one country (like for example in Ireland) makes the comparison even more complex. For the above reason, we support the Commission's intention to establish a list of costs that should be part of *APR*, as well as an EU harmonised method of calculating them under the mechanism of full harmonization. This would enhance firstly the consumers' ability to compare different products and the level playing field between competitors.

3. 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.

ABN AMRO supports that the information on costs not included in *APR* as well as on the effects of *APR* on cost per month and overall costs should be provided to the borrower. However, all this information should be included in the mortgage offer and not '*separately*' as suggested by the Commission.

5. Usury rules and interest rate variation

The Commission notes that some Member States impose restrictions on the imposition of compound interest rates. Do such restrictions hinder market integration? What impact can they have on the development of particular products such as equity release products?

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

We agree that usury rules should be considered at the EU level. However, they should be examined in a broader context (e.g. consumer credit). Those rules should be established in a reasonable way and be linked to a benchmark (e.g. EU Interbank Offered Rate, EUIBOR).

We are not in favour of the restrictions on the imposition of compound interest like in some Member States. The impact of such restrictions on the development of particular products such as equity release products will be negative: this will make the equity release product that uses negative amortization (loan increased with interest) impossible since with this product the interest is added to the loan and the loan amount is increased with the compounded interest. Those equity release products are also very important from the pensions' point of view.

6. Credit contract

The Commission welcomes views on the merits of the standardisation of mortgage contracts, e.g. via a 26th regime instrument (a legal instrument sitting alongside, but without replacing, national rules, and available as an option to the parties to a contract.)

- ABN AMRO is in favour of standardisation of mortgage contract, but not under the form of 26th regime. The 26th legal instrument would not contribute to enhance cross-border integration of credit contract. In addition to 25 different regimes on mortgage contracts, it would add another 26th regime. Each Member State would have a choice between its own national regime and 26 regime. On a cross-border basis, it would not simplify, but complicate even more the already complicated situation in the EU market.
- We are of the opinion that standardisation should take place via **maximum harmonisation**. This mechanism would provide the market players with certitude that all EU countries use the same standard mortgage principles and can not put in place additional, more severe rules compared to those agreed. It would result in a real harmonisation of national rules. It would therefore facilitate cross-border mortgage business. Also, it would enhance legal certainty for consumers and a level playing field for lenders since all the parties would be sure that the same standard is used in all the Member States.

Furthermore, the harmonisation of mortgage contracts would make execution of our Residential Mortgage-Backed Securities (RMBS), especially for new clients quicker and more efficient. If documentation is more standardized, mortgages from different Member States can be pooled together and used as collateral for a combined transaction. This will increase the speed or the size of the deals and will therefore lower costs, resulting in more efficient funding. In addition, European Securitisation and/or covered bond legislation would greatly help this process.

7. Enforcement and redress

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?

ABN AMRO is in favour of developing more alternative ways of redress and improving existing systems in other Member States since in The Netherlands this system works very well. ABN AMRO also supports that Commission's idea to impose on Member States an obligation to ensure the existence of such alternative means of redress in the mortgage credit area.

In The Netherlands, the system of alternative dispute resolution offers consumers the possibility to complain to an independent committee. The costs associated with such procedures are not significant and the committee can decide very quickly in comparison to court proceedings which are long and costly. Both consumers and lenders are bound by the decision of the committee. This system works very well.

III. LEGAL ISSUES

1. Applicable Law

The Commission is asking which law should apply to mortgage credit contracts concluded cross border.

With regard to some solutions identified by the Commission, we are in favour of excluding the application to a consumer mortgage credit contract of the consumer's mandatory protection rules, provided that there is a high level of (mortgage based) consumer protection in place at EU level. Regarding the law applicable to the collateral, we also support that the law of the country in which the property is situated applies.

It would be easiest for all the parties if the law of the country where the property is located is used both for the mortgage deed as well as the credit contract (*lex rei sitae*). As long as lenders are allowed by the regulator (using their EU passport) to underwrite loans in other Member States there are no obstacles to use the law of the country of the property. (e.g. if a Dutch client buys a house in Italy, we prefer that the mortgage credit contract is subject to the Italian law.).

2. Client Credit - Worthiness

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.

ABN AMRO supports facilitating cross-border access to databases on a non-discriminatory basis. Fair access to national database to foreign lenders will protect mortgage credit providers against insolvency risk and consumers against over-indebtedness risk. Also, we think the Commission should encourage development of positive database (client indebtedness) as well as negative (level of default) databases so that each lender has access to the similar level of information in each Member State. For instance in the Netherlands there is both positive and negative database. It would be useful if we could have access to a similar type of database in other Member States. Then, we would also welcome the Commission's initiative to harmonise the content, structure and the format of the national databases so that their consultation is made easier.

However, those potential initiatives should be based on a thorough cost-impact analysis so that the benefits of this action are greater than investment costs. Should there arise a duty to check all EU databases on credit-worthiness, careful consideration should be

given to the associated costs for the lenders. In principle we are of the opinion that it should be a right to check other databases, not an obligation. Should it be obliged than only on the premises that consultation is made easy, cost efficient and can be done electronically in all Member States.

3. Property valuation

1. What are the merits of a single EU standard, for both valuation processes and valuers?
2. What are the merits of Commission action to ensure mutual recognition of national valuation standards?

We support the creation of EU standards with the minimum requirements for valuation coupled with **the mutual recognition principle** (each Member State has to accept valuation standards of each other Member State) as far as:

- The choice to carry out a valuation is left to the lender. The lender (who is taking the credit risk) should be allowed to decide not to value a property (that valuation should not be mandatory in case adequate valuation has already been done, e.g. for tax purposes). Therefore valuation itself should not become compulsory for the lender.
- Credit institutions conserve their control over the choice of the valuator and the final decision whether to accept or not the valuation since valuation process is part of the lenders' risk assessment. Therefore, would not like to be obliged to refer to a new single valuation institution.

We also support the proposal to allow financial institutions:

- To accept valuations prepared according to internationally recognised valuation standards of its choice, without being subject to additional national conditions.
- 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.

4. Forced sales Procedures

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.

The Commission should above all promote measures to ensure that the duration of a forced sale procedure should not exceed a specified term (e.g. 2 years). In some countries (e.g. Italy) the foreclosure procedure should be made quicker. This would have a positive impact on securitisation in jurisdictions where the foreclosure process takes longer than 2 years. The longer the recovery period is rating agencies penalise RMBS transactions since this impacts cashflows. This initiative is supported especially from a securitisation perspective.

We also support the 'gradual approach' to encourage improvements in forced sales procedures as proposed by the Commission.

5. Tax

The Commission seeks information on tax obstacles to the cross-border provision of mortgages, which are likely to infringe the freedoms provided for by EU law.

National tax systems hinder seriously the cross-border provision of mortgage credit. Obstacles are indeed the refusal of tax deduction for interest paid to foreign providers even if interest paid to domestic providers is tax deductible, higher taxation of such interest, complex and different tax systems, subsidies etc. Thus we favour Commission's initiatives aiming at the removal of those obstacles.

IV. MORTGAGE COLLATERAL

1. Land Registers

The Commission would welcome input on:

- **Contents and operation of land registers**
- **Facilitate cross-border access to them**
- **Concrete benefits of this initiative**

ABN AMRO favours ensuring that all charges affecting real estate must be registered in a Public Register and that this information is made available to all parties including foreign lenders. Therefore, we are in favour of the cross border access to land registers between all Member States. This would assist securitisation in terms of certainty over title to property. This initiative would be of great interest for both consumers and lenders. We also favour harmonisation of the content of such land registers as well as the format and functioning of land registers so that all the parties from different countries have easy access to the same type of the information.

For example, in the Netherlands, the system works as follows:

The "Kadaster" registers all properties, their owners and the persons having any claims or mortgage on the property. It is a public register that can be accessed by any person which also shows the selling price of the property. The Notary is responsible for checking the Kadaster to see if there are any other claims, mortgages or charges on the property before the mortgage of the lender is disbursed. The Notary will register the new mortgage and provides the lender with a copy of the mortgage deed that has been registered in the Kadaster.

2. Euromortgages

The Commission invites views on the feasibility and desirability of the Euromortgage. It will in any event, await the outcome of ongoing initiatives to inform its assessment of this issue.

ABN AMRO is sceptical about the real added value of any initiative in this area. The idea of euromortgage attempts to create "one size fits all solution". This would not be appropriate given the completely different structure of mortgage markets within the EU (especially deep differences in mortgage credit markets between "old" and "new" Member States).

V. FUNDING OF MORTGAGE CREDIT

The Commission to examine the need for and nature of action on the funding aspects (primary and secondary) of mortgage credit.

Covered bonds and mortgage backed securities play indeed a very important role in a pan-European as well as national context. We are in favour of the harmonisation of securitisation law, (including notification procedure). A common EU securitisation and covered bonds law would help to further develop and integrate this market. Pan-European funding mechanisms have the potential to increase sources of funding, create more liquid markets and more generally allow for better distribution of risk. Thus we support initiatives in this area.

ABN AMRO is willing to enter into further discussions with the Commission about this topic.