

HBOS RESPONSE TO THE COMMISSION'S GREEN PAPER ON MORTGAGE CREDIT IN THE EU

INTRODUCTION

HBOS supports open, competitive and efficient markets. This is to the advantage of consumers, firms and to economic growth within the EU. We are active in the mortgage market in the United Kingdom, Spain, The Netherlands, and Ireland. With this background HBOS approaches its mortgage proposition with the objective of lending responsibly to meet consumer needs. To do this, we emphasise some key principles and apply these to those businesses. This sits beside any regulatory obligations we have to national supervisors. In brief, we characterise these as a commitment to:

- Focus on the quality of all documentation with emphasis on clarity of product features, terms and conditions.
- Describe the key features in a way that makes comparability easy and facilitate shopping around.
- Enable the consumer to exit from the transaction at any time.
- Support a clear statement of practice for collections.
- Adopt a clear statement of practice for dealing with customers in difficulty.
- Subscribe to independent arbitration in the case of complaints where appropriate.

If such principles were to be embedded in EU market practice, then market participants would meet them in ways appropriate to the market in which they operated and in ways that met their consumers' different expectations. Consumer confidence could then develop and they in turn may be prepared to consider dealing with a wider range of providers throughout the EU.

At the same time, as lenders, we encounter variances in different Member States which, taken together, undermine our interest in participating more comprehensively in the Single Market. This in turn, works against the development of an integrated market. For instance, the variations in tax treatment and rates, often a key component in product design, discourages a pan-EU approach. While we accept that this issue will not be addressed by the EU institutions for other reasons, it presents a significant challenge to lenders considering a pan-EU product range.

Further, lenders advance funds to consumers whom they believe can repay those loans and, where there is a default, to be confident that any rights to collections or repossession are enforceable. Differences in contract laws, differences in land registration, differences in valuation standards and differences in credit-worthiness databases can each diminish a lender's appetite to enter new markets.

We do not suggest that a mortgage directive would solve these dilemmas. Indeed we do not suggest that the solutions need to be regulatory in nature but some convergence of EU standards and principles is necessary to encourage the market to develop towards a more integrated model and to encourage consumers to develop trust in an integrated market. This is most likely to happen organically over time (and so with experience) than via a 'big bang' approach.

Definition of a Mortgage

We wonder whether it might be a useful exercise to develop a common understanding of the term mortgage. This is not suggested for legislative drafting reasons, but for the development of common terminology with which consumers can become familiar and in which they can have confidence.

London Economics in the Cost Benefit Analysis (CBA) says it is "impossible to define mortgage or home loans in a manner satisfactory for all EU countries".

Our view is that the Commission needs to do further research on this point. As a starting point, we suggest that any definition should be objectively verifiable and should not depend on the purpose of the loan.

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

The European Code is a relatively recent initiative and should be given an appropriate period in which to meet its objectives. As we have said, we do not believe that the regulatory regime (be it regulatory, co-regulatory or self-regulatory) presents the biggest or most immediate barrier to an integrated market and so to consider this question at this time should not be the focus of the Commission's attention. We feel that other issues such as the legal and practical differences such as registering the legal charge should be tackled before transaction related issues.

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

Consumers should always be given sufficient and timely information to enable them to make an informed choice. All consumer documentation should be clear, fair, and not misleading.

At the first point of contact the consumer should be given a disclosure document containing a wide range of basic information: the identity of the legal entity the consumer is dealing with, and the type, scope and costs of the service being provided. This is beneficial to the consumer, as from the outset it is clear whether advice is included, at what cost and how many lenders will be considered.

The consumer should also receive, before applying for any mortgage, key product information, such as the product rate(s), the Annual Percentage Rate, as well as the term of the loan. This information will give the consumer enough information to make a cost comparison and shop around.

Regarding the APR, we do not support the suggestion in the London Economics report that there should be two APRs. Our view is that there should be one rate for comparison purposes. Two rates could cause the consumer confusion.

3. 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?

The focus should therefore be on providing the consumer with information before the application stage. Customers should be provided with information as early as possible to allow them to make an informed decision before receiving a binding offer. That would allow them to proceed with an offer that would be most suited to their needs. Comparability of terms and features facilitates shopping around at the earliest stages in the sales process.

4. 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?

Consumers should receive the same information about a mortgage regardless of the distribution channel they use, taking into account the technology involved in that particular channel. Therefore, any firm that sells mortgages should be subject to the same standards and obligations. Only those who deal with consumers should be subject to information disclosure requirements.

Where there are firms such as 'packagers' whose primary role is to provide administrative support to lenders or brokers, they do not have to issue customers with any regulatory or other documentation and have no customer contact. If a packager firm wants to do more than just act purely as a 'packager' then they should be subject to the same requirements as any other firm doing that activity.

This would ensure that all consumers receive equal or equivalent treatment. While we think that there should be consequences for firms not discharging their obligations this does not mean we support a prescriptive information disclosure regime

Compliance with an information disclosure regime could be assisted by the creation of a licensing regime for all firms that deal with consumers. In order to ensure compliance with an information provision regime we believe that a range of tools would have to be employed, including the threat of withdrawal of licence. This should also include the powers for the national regulator to levy fines, publish formal reprimands to give adverse publicity to a firm.

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

HBOS does not support a compulsory offering of advice, that is, advice leading to a personal recommendation. We believe that customers must be able to choose whether they receive advice or not. They may find it difficult to accept that as a matter of policy they do not have the right to choose whether or not to have advice where they have the financial experience or expertise to make an informed choice, or they may know the product they want.

There may be some confusion as to the term 'advice'. We suggest a recommendation on a specific product to a customer would be advice but generic recommendations would not.

There is definitely a market for advice in mortgages. Some consumers wish to have it and in some instances firms believe it is necessary. We ourselves offer advice in some circumstances, if we consider the product complex, but do not believe it should be uniformly required or offered.

HBOS believes that 'advice' would cover:

- Suitability of product choice.
- The range of lenders disclosed from a single provider to whole of market.
- Affordability.

However, 'advice' would not cover:

- Any ongoing suitability requirement, as suitability is determined on the day the advice is given.
- The treatment of arrears.
- Ancillary products.
- Any consideration of whether the property being acquired is suitable.
- Any consideration of suitability of the price of the property.

Advice also needs to be defined in terms of who can give it for example:

- By qualified adviser only facing a customer.
- By qualified adviser on the telephone.
- By a website that offers advice following questions that have been scripted in advance or following a 'decision tree'.
- By literature that offers advice.

The number of available mortgage advisers in the market is also an issue to consider. The numbers of advisers in the UK is currently insufficient if a mortgage sale could only proceed with an advised service. The transition to any new regime would be key, in particular any arrangements for 'grandfathering' mortgage sellers for a period to allow them time to continue selling without requiring any additional qualifications to be able to give advice.

If advisers had to give whole of market advice then there could be a shortage of advisers at the outset. Consideration would also need to be given as to what constituted additional qualifications to ensure that standards are consistent across the market.

Having insufficient numbers of qualified advisers would increase the delays involved before a customer could see an adviser. This could develop into a long-term issue if not addressed. This would increase the time pressure to secure the home purchase transaction. It may reduce the likelihood of customers being able to shop around.

The remortgage market in the UK allows customers to change their mortgage to a cheaper lender without moving home. Remortgaging benefits consumers whose monthly repayments fall. It also influences the mainstream market in keeping prices down. If transactions in this market required advice, this could have an adverse effect as it would:

- Reduce the likelihood of customers shopping around.
- Increase costs in a market with already low margins.
- Reduce the availability of cheap products.

Compulsory advice would increase the costs of those selling mortgages and probably in due course the costs to customers because:

- Currently a significant proportion of sales are made without advice –advisers are a more expensive resource.
- More sales supervisors would be needed to maintain existing spans of control.
- Training and competence schemes would need to be expanded to ensure that more sellers are capable of giving advice.
- IT systems would need to be adapted to cope with additional record-keeping requirements.
- More extensive compliance oversight functions would be required to monitor performance.

These cost increases would be passed on to customers. The increases could be aggravated if advisers have to provide advice on products from the whole of the market.

The costs involved could force some lenders to instigate a minimum loan requirement to ensure that transactions are cost effective. This would adversely affect public policy as smaller secured loans are often used for home improvements. Home improvements by individuals collectively ensure a better neighbourhood. If individuals are unable to access funding to improve their properties then the physical environment of a neighbourhood can decline.

When a customer receives advice, there is always the possibility that he will decide against following the advice. It needs to be clear what options are open to the provider in these circumstances. The provider should be able to proceed on a scripted question or execution only route to allow the customer to choose the product they want. To protect the customer, the provider should confirm to the customer the advice that it has given, and that the customer has chosen not to follow the provider's advice. This process would ensure the greatest possible flexibility for the customer to find a product that meets his own needs.

In a highly competitive market such as the UK, it is essential that mortgage providers have the flexibility to choose their own operating model to meet the needs of their customers. A mandatory advice route restricts flexibility.

Distribution via the internet would be at risk if advice became mandatory. The internet channel more readily lends itself to the informed customer via scripted questions or a decision tree, than it does to a sale via advice. Advice should be reserved to a channel where the customer has access to an adviser rather than the complexities of making a website capable of giving advice.

We support a regime where customers have the option of obtaining advice or purchasing a mortgage from a seller who uses scripted questions. Set questions ensure consistent and fair treatment of customers. Compliance with these questions can be monitored.

6. 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)?

We prefer that a set of standards and principles evolve and that market practitioners meet these in the manner best suited to their consumers and their business. Any regulations necessary in this area should be left to national supervisors.

7. 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?

We support the absolute right of the consumer to repay the entire debt early. We do not agree that the consumer should be able to waive that right. However, we believe that lenders should be able to recoup all of the costs where the consumer repays early.

Consumers want to have the option of choosing fixed or variable rates. Fixed rates are financed in such a way that lenders would lose money if interest rates fall and mortgages were redeemed during the fixed rate period or for a defined period afterwards. Fixed rates are popular with consumers who prefer a stable monthly payment, as it allows them to budget with certainty and eliminates interest rate risk for the duration of the fixed rate period. If lenders were unable to recoup their losses when consumers redeem fixed rate loans then this would have a significant impact on the availability of fixed rate products. Consumer choice would be reduced and prices would inevitably rise when the risk of early repayment is factored in.

Conversely, the presence of early repayment charges results in reduced risk of attrition or of account closure. This enables lenders to offer cheaper products to consumers, in exchange for greater stability within the book/ portfolio.

Please see the following section for our view on compensation for early repayment.

8. 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?

Early repayment fees are payable in scenarios where the consumer agrees to take a short term product such as a two-year discounted fixed rate but afterwards wants to exit before the end of the two-year period. The benefit to the borrower is that they can obtain a low introductory rate allowing them to buy their home now rather than miss their choice of home and wait until they can afford the normal market interest rate. The opportunity to access such cheap rates is a key consumer benefit.

Consequently for lenders to continue offering these products we need to be able to price the products to ensure that if consumers leave before the agreed period we are in the same position as if they had stayed to the end of the agreed period. So the early repayment fee should include not only the cost of breaking the deal but also the fee needed to ensure that lenders have not lost out through offering that product to a consumer who leaves early.

The alternative is that the early repayment charge only reflects the losses to the lender on the cost of the funds and excludes the administration costs or the losses taken on the product if kept to the end of the term. In this scenario, it may be beneficial for consumers to leave and pay the early repayment fee to avoid paying the higher rate in the last year that would have subsidised the first years. If the lender cannot charge a fee that would put him back in the position of the consumer staying for the period then that could result in lenders no longer offering these products to the detriment of consumers. Each lender should be able to justify the fairness of their calculation of their early repayment fee.

We do not agree with the idea of a cap on early repayment charges. A cap would represent an artificial limit on a free market where both parties should have the right to choose. Consumers may want to commit to a low cost offer to secure low payments for a set period. The opportunity to do so could be critical to them.

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

The consumer should be informed about the availability of early repayment and the relevant charges in pre-application information disclosure. The information should be in a durable medium to allow the consumer to retain a copy.

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

Our view is that the APR's purpose is to provide a cost for comparison only. It does not provide a measure of how much the consumer will actually pay.

In our experience, the average life of a new mortgage is less than four years. However, the APR is calculated over the full term of the loan, usually at least 15 years. Therefore, the APR is only useful as a guide for comparison.

However, given that mortgages are such a complex product it is helpful to have one APR to give consumers an idea of how the overall price of their mortgage compares with others. Overall, the APR is a valuable way of indicating the impact of fees on the total amount payable over the life of the loan.

11. Should there be a EU standard covering both the calculation method and the costs elements?

Yes and it should cover all forms of credit not just mortgages or all secured lending. This would allow consumers to compare the cost of credit from whatever source or distribution channel.

It is important to consider the level of tolerance of accuracy for the APR in documentation. Many intermediaries use external sourcing systems. These are point of sale software packages that allow intermediaries to input the borrower's details once and have access to products from many lenders. The alternative for an intermediary is to access a lender's website. If the preferred product were not available on that website then all the details would need to be rekeyed on another provider's website. We would suggest that whilst information from lenders themselves has to be accurate, an intermediary's APR cannot be understated by more than 0.1%. We feel that this is an appropriate balance between the interests of the consumer and the costs incurred by intermediaries in accessing key information.

12. If so, what kinds of cost elements should such a EU standard include?

We would suggest that the EU standard might include:

- What lenders require consumers to pay as a direct consequence of the credit agreement on the assumption that the agreement runs to the full term.
- Costs the borrower is required to pay whether they are added to the loan or paid up front.

We think it should not include:

- Costs, which lenders incur but do not charge consumers such as procurement fees which lenders pay to intermediaries for selling the mortgage.
- Optional fees or insurance premiums.
- Costs that the consumer may not incur such as early repayment fees, product transfer fees or arrears fees.
- Costs associated with the property purchase or legal fees.

It is important to combine this with a requirement to disclose separately all the fees that have been included.

13. 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.

The APR is best expressed as an annual rate. To start analysing the APR in terms of costs per month or other ways might cause consumer confusion. It is possible that some consumers could mistakenly believe that they will be paying that cost every month.

It may not help the consumer's decision-making to see the APR expressed as a monthly cost. A key consumer concern is how the monthly payments will be met. If a consumer plans to pay some fees at the outset, then the APR expressed as a monthly cost would not help affordability because it is taking items into account that have already been paid. The consumer may prefer to compare the actual monthly cost of different products as this bears on what he can afford.

We would support an approach where the lender is required to state the total amount payable and the proportion of which is cost. This gives the consumer key information before a mortgage application is made.

Mortgage documentation should only contain the costs of a mortgage not costs of the house purchase such as a borrower's legal costs, the costs of a valuation or estate agency fees. It is not practical for lenders to obtain them nor does it help consumers shop around.

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

The drafting of any rules should not interfere with the operation of a free market where competition is the key influence on price. Risk-based pricing can allow access to products that would otherwise be inaccessible. Rules on usury should be designed to catch only those loans that are so much out of step with the rest of the market that regulatory action is necessary.

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

Yes, this issue has to be examined in the context of all credit products, secured and unsecured.

16. Do such restrictions hinder market integration?

Such restrictions should not hinder market integration depending on how they are implemented. They should be principles-based, high-level rules.

17. What impact can they have on the development of particular products such as *equity release* products?

Equity release products are vital for the increasing consumer segment of households who are asset-rich but cash-poor. Any restrictions should not adversely affect the development of this market. A regulatory regime should focus on information disclosure and adequate training and competence schemes for advisers, sellers and supervisors of the sellers of these products.

18. The Commission welcomes views on the merits of the standardisation of mortgage contracts, e.g. via a 26th regime instrument.

This work cannot occur in isolation. Mortgage contracts have been developed in the context of national property laws and national rules on land registration. Significant further research is needed to establish whether common terms could be developed for all mortgage contracts.

We believe that all consumers across the EU should be entitled to the same degree of consumer protection. They should receive the same information in the format facilitating comparison wherever they purchase their mortgage. It should not make a difference whether they choose a lender with an establishment in the country where the property is located or not.

While we accept that, for firms and consumers alike, familiarity with a domestic and a 26th regime could be less onerous than familiarity with all 25 regimes, we are not yet convinced that its introduction would yield such an outcome in practice. We admit the idea is interesting and would welcome any further research the Commission published.

19. 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?

It is vital for consumer confidence that an accessible redress mechanism is available. This might include alternative dispute resolution options, or an institutional dispute resolution scheme such as an independent ombudsman scheme. There would need to be a framework ensuring a degree of consistency between schemes and their decision-making principles. Consumers should have the right of redress according to the jurisdiction in which the property is located.

20. The Commission welcomes views on ways to reinforce the credibility of existing alternative redress systems, particularly in the mortgage credit area.

To reinforce credibility it would be helpful to ensure:

- Decisions are consistent between national ombudsmen.
- That where decisions would have a wider impact then there is a process of liaison with national regulators EU and the local mortgage industry to ensure that all the potential consequences are taken into account.
- That the decisions of the Ombudsman are taken seriously by participants in the scheme for example non-compliance with determinations can be referred to the appropriate regulator and the complainant has a right of civil action to enforce a determination.

21. 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.

Access to databases is critical to an integrated EU market to facilitate underwriting. However, to integrate the data sets and transmission methods used would be a complex and costly exercise that would cause numerous problems, such as language barriers, currency conversion and common data definitions. An effective data-sharing agreement in each member state is a credible starting point.

Clearly consideration would have to be given to Data Protection requirements.

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

We would support a single EU standard for both valuations and valuers. This would lead to greater consistency of valuation techniques across Europe.

23. What are the merits of Commission action to ensure mutual recognition of national valuation standards?

We are aware that international standards exist already but that these have not received universal acceptance. We would therefore support movement towards consistent standards for valuation across the EU, since standardisation would assist lenders operating across different member states.

There could be a role for the Commission to facilitate this move, in particular by using its powers to tackle some of the current restrictive practices operated in some member states.

24. 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.

We would support the gradual improvement of rules on arrears and forced sale procedures within Member States. Laws or guidance that governs the balance between waiting to obtain the best price and selling as early as possible to stop interest accruing and crystallise a consumer's shortfall are important.

It is essential that both borrowers and lenders have confidence in any legal system governing realisation of security. Borrowers must have confidence that adequate protections for them are built into the system and lenders must know that, subject to those protections, they will be able to realise their security in appropriate cases of default.

The post-possession sale process is an important component of a lender's assessment of a new market. For instance, in the UK such properties are usually marketed through estate agents to achieve the best possible price for the property. This in turn reduces the potential loss that the lender can make and consequently reduces the shortfall that the consumer has to pay. Consumers are liable to pay lenders for the loss that lenders make on the sale of the property. It is in the consumer's interests that the lender secures the highest possible price for their property.

If the flexibility above was threatened and the property sold by auction then the consumer could lose out if that did not generate a good price and the debt the consumer owes his lender could increase.

Furthermore, as soon as a mortgage account goes into arrears, lenders have to make a provision in their profit and loss account for the potential losses that could be realised if the property were sold at a loss. The difference in provisions would be significant if all repossessed properties were to be sold at auction soon after the repossession rather than to be sold by estate agents.

25. 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.

We would support further research into this.

26. Before making further assessments, the Commission would welcome input on all these issues.

Our view is that such work is vital to the integration of EU mortgage markets. As such, it is appropriate for the EU to fund it. Whilst lenders and consumers will ultimately benefit, the main stakeholders are the European Union and Member States who own national land registries. At this stage we would not be able to provide funding to this project and in any event do not feel that it is appropriate for lenders to do so.

27. 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.

A proposal for a Euromortgage is an interesting idea and we look forward to the outcome of the Commission's research in this area.

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

HBOS is the largest European residential mortgage lender and is keen to participate in this working group.

29. 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.

A level playing field offers opportunities for firms and consumers alike; however, we agree it should not be automatically assumed it requires regulation. Development of consumer protection principles and embedding them in market practice through competitive or peer pressure should result in the evolution of a consistent environment that can give reassurance to both consumers and firms when considering going outside their normal market.

30. 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.

There should be no artificial limit on the types of persons who can engage in lending or selling activities. Being a deposit taker should not be the criteria by which a firm becomes eligible to offer mortgages. All lenders should meet the same standards within their jurisdiction irrespective of whether they are a credit institution or other body.