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COMMENTS OF THE CZECH REPUBLIC ON THE COMMISSION SERVICES GREEN PAPER - MORTGAGE CREDIT IN THE EU

Referring to the European Commission Green Paper - Mortgage Credit in the EU of 19 July 2005, the Czech Ministry of Finance hereby gives the comments of the Czech Republic.

This document was prepared in cooperation with the Ministry of Industry and Trade, the Ministry of Justice, the Czech National Bank, the Czech Banking Association, consumer organizations and other experts.

1. GENERAL COMMENTS

We welcome the consultation process organized by the European Commission on the mortgage credit integration. We believe that the process ensures that all measures will lead towards removing obstacles to mortgage market integration and ensure the achievement of the presumed benefits of integration mentioned in the cost and benefit analysis. The aim of the integration should be a more efficient and competitive mortgage market contributing to the growth of the EU economy, facilitating movement of the labor force, while respecting and protecting consumers' rights and concerns.

It is in the interest of the Czech Republic to support efforts towards the integration of the mortgage market, the maximization of its effectiveness and profitability, while preserving strong consumer protection and an efficient competitive environment. The answers given by the Czech Republic are in accordance with this essential position.

The European Commission formulated 33 questions within particular chapters of the Green Paper. These are the Czech Republic's comments.

2. CONSUMER PROTECTION

2.1. Information

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

The Code of Conduct should be replaced by binding legislation.

The primary objective of the Code of Conduct was to ensure transparency and comparability of pre-contractual information for home loans uniformly in the EU. According to the study which followed, the Code of Conduct did not achieve its aim and implementation of its rules was not uniform and satisfactory. That suggests that voluntary and self-regulatory mechanisms have not worked in this area.

Efficiency, timeliness, transparency of information provision and its equilibrium and comparability at the EU level are one of the prerequisites of the integrated mortgage market. It is necessary to ensure unified application, interpretation and subsequent supervision of the adherence to the rules for achieving these objectives. The only possible way in which to achieve this is through binding legislation in the maximum harmonization regime, at best in an EU Regulation taking into account experience with the Code of Conduct and the European Standardized Information Sheet (ESIS).

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

Mortgage credit applicants seeking detailed information previous to taking out a mortgage loan should receive such information as will inspire them towards the next step in choosing a suitable product. Pre-contractual information should also contain information concerning the risks and consequences if a client defaults. It would also make it easier for clients to compare offers for similar products from different credit providers. The primary requirement is the clarity of this information, as it is not a legal document but basic information about the product. This matter is crucial to reinforce transparency in the mortgage credit market.

The level of pre-contractual information must be balanced. We recommend following the structure of the Code of Conduct and the European Standardized Information Sheet. Some elements of the ESIS should be spelled out in greater detail in order to make comparison easier. The standardized dictionary of technical terms should also be a part of the pre-contractual information.

The methods of calculating the Annual Percentage Rate (APR) should be determined clearly and uniformly in the EU.

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?

In the Czech Republic it is possible for the client to receive all necessary information (following the structure of the Code of Conduct and the European Standardized Information Sheet) before signing the contract and before the time when both parties actually start incurring costs (e.g. property valuation, paid enquiries into the credit registers).

We recommend providing as much information as possible according to the ESIS starting at the stage of comparing products of competing mortgage providers, thus at the moment when the consumer first expresses interest in the possibility of a mortgage credit contract. The provision of general information and a certain amount of detail of pre-contractual information could be ensured, in particular through the Internet so that the client could compare the products at the maximum possible extent at home and not at the time of negotiating the contract. If there is a need for additional information or more specific details, it should be possible to obtain information on demand (at the bank premises or through other methods of distant access, e.g. ADC – Advanced data connector)

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?

Yes, all the providers and intermediaries should follow the same rules.

Also others should be obliged to provide information according to the regime applied on the mortgage providers. Intermediaries should be required to provide general information and a set of information according to the Code of Conduct and the European Standardized Information Sheet if the client expresses interest in mortgage contract intermediation.

Banks and the intermediaries should be required to provide each other with all sufficient information. The issue of intermediaries is to be dealt by the European Commission horizontally for the whole financial services sector. In the meantime, it would be appropriate to set out this requirement in binding legislation regulating information provision (as mentioned above).

2.2. Advice provision and Credit Intermediation

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

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)?

The client should receive general advice about particular products in the pre-contractual stage both from the mortgage provider and the intermediary in a way similar to that specified in the Code of Conduct and the European Standardized Information Sheet already in pre-contractual phase. The general advice provision should be obligatory and in compliance with conditions set out in EU legislation.

The provision of advice should carry a charge or be voluntary. And it is desirable that it be of high quality, independent, complete and transparent. Particularly in the case when a fee is charged for providing advice, it is necessary to ensure these conditions by binding legislation. We presume that the advice provision issue will be addressed horizontally in the EU.

Concerning the standards for information provision, we prefer written or electronic (email) advising as other forms can entail questionable interpretations and possible abuse by the party in a stronger informative position.

2.3 Early Repayment

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?

The right to early repayment should be stipulated directly in legislation where it should be explicitly stated that the consumer must not be deprived of the right. The consumer cannot waive this right in advance. Thus, legal rule should stipulate that the consumer has the right to early repayment and that early repayment and its conditions must always be specified in the mortgage contract.

In the case where the consumer is required to pay certain fees for early repayment, it is necessary to ensure that the consumer be informed in the pre-contractual information and also during the writing thereof (this information should be a part of the contract). It is also necessary to inform the consumer about the way fees for early repayment are calculated and set; it should exempt the consumer from any duty to pay any contract penalties for early repayment.

In addition, we propose stipulating the right to early repayment of the whole or part of mortgage credit at the time of the end of interest rate fixation term, which should be free of charge. A higher level of regulation is not appropriate due to the possible negative impact on the competitive environment.

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?

We do not support setting any caps because the structure of compensation results from up-to-date differences in interest rates, which cannot be forecast. The fee for early repayment traditionally reflects a loss or more precisely unachieved planned profit, due to the loss of interest rate yields from reserved sources.

Both methods and basis of calculation should be stipulated uniformly in the EU, leaving open the possibility of adapting it to various forms of mortgage credits and their financing.

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

The consumer must explicitly and clearly receive information regarding the early repayment both as part of the pre-contractual information and in the credit contract. The consumer should be informed about the conditions applying to the obligation to pay fees as well as about the method of fee calculation and setting.

Currently, there is room in particular in the areas of increased quality of consumer awareness and in the method of uniform provision of obligatory pre-contractual information. The issue of consumer education should be addressed horizontally and generally in the field of financial services with the involvement of secondary and higher education.

2.4 Annual Percentage Rate

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

The purpose of an APR is both information and comparison. The APR is a kind of information that clearly and briefly enables the consumer to compare different competitive products. The correct setting of the rules for the APR is one of the preconditions for achieving an integrated mortgage market.

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

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

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.

Rules for method of calculation and costs elements should be set out in EU binding legislation, just as in the case of rules for information provision.

As the APR is a main instrument enabling easy product comparability, its conditions should be made as specific and uniform as possible. The APR should include all costs which must be paid to the bank by the consumer in connection with stipulation of mortgage credit and which can be expressed in exact figures at the time of providing information. Fees to be paid to the bank which are not included in the base APR calculation should be clearly stated and enumerated. Its possible effect on APR should be explained and stated for instance in the amortization table.

We would welcome a study dealing particularly with the APR, the possibilities of its being set in the EU and the question whether it is possible to set the APR uniformly in the EU so that the APR really effectively fulfills its role as the main instrument for product comparison.

2.5 Usury Rules and Interest Rate Variation

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

We do not agree with setting usury rules. The setting of fixed maximum interest rates in binding EU legislation could be an obstacle to business development at the time of fluctuation and time-limited increase of interest rates and the money value. General usury rules in criminal law and the prohibition of dominant position abuse offer protection from exorbitant interest rates in the Czech Republic.

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

No.

16. Do such restrictions hinder market integration?

Yes, we believe they do. There are categories of risky clients, where higher interest rates are necessary. As newcomers are focusing on those clients who were turned down by existing competitors because of their risk rate, this limitation would have a negative impact on cross border activity of mortgage providers. We might further add that products such as equity release have a generally higher risk rate which must be reflected in a higher interest rate.

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

Usury rules regulation could lead towards the limitation or restraint of risky product provision. Thus, towards the end of such products market. Despite their risk rate, these products are necessary for the market. The higher risk

level is reflected in a higher interest rate. We do not agree with the implementation of interest rate caps.

2.6 Credit Contract

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

We do not agree with the standardization of a mortgage contract format. This step is redundant, as banks could not then deal individually with clients. We would put a higher priority on ensuring the transparency and comparability of pre-contractual information, as mentioned above. The benefit of the standardization of mortgage contracts is not significant for the client, as the client with knowledge of pre-contractual information has already made a decision about getting mortgage credit at the time he or she signs the contract. Moreover, because of the decrease in competition, it would virtually make no sense to consider integration since it would abolish all the positive effects stemming from the considerable amount of various and diversified competition regulated by different legal systems. We support the standardization of pre-contractual information, which we consider sufficient.

2.7 Enforcement & Redress

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?

Yes.

We support using alternative means of redress among parties as an option to court trial or arbitration trial. In this respect, we support a horizontal solution for the whole area of financial services. In particular, it will be necessary to ensure the effective functioning of these means of redress for solving cross-border disputes. The FIN-NET system should be used particularly in this regard. Currently in the Czech Republic preparatory work is under way on a Financial Ombudsman Act. The financial ombudsman should among other things offer an alternative for settling disputes arising from mortgage credit provision.

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

It is necessary to ensure that alternative redress systems are easily accessible, effective, cheap and independent; and that their resolution of disputes is transparent, fast and of high quality. This should be ensured within the preparation of the EU directive concerning certain aspects of mediation in civil and commercial affairs. Any decision of the alternative

redress body must be legally binding after coming into force (i.e., it should be an enforceable title); otherwise, the whole proceeding will have lost any meaning. There should be also provision for terminating a dispute through conciliation with the legal effect of a consent decree, so it would be also an enforceable title.

That should be without prejudice to the right of a participant to claim judicial review so that the right to a fair trial in the sense of article 6 of the European convention on human rights is guaranteed.

3. LEGAL ISSUES

3.1 Applicable Law

21. Provide for a specific regime for the law applicable to consumer mortgage credit contracts in the future Regulation. This could consist of aligning the law applicable to the mortgage credit contract with the law applicable to the collateral contract.

22. Continue to subject mortgage credit contracts to the general principles which, in the Rome Convention as it stands, would mean essentially that parties can freely decide on the law applicable to their contract, subject to the application – under some conditions – of the mandatory rules of the consumer’s country of residence.

23. Exclude the application to a consumer mortgage credit contract of the consumer’s mandatory protection rules, provided that some conditions are met, for example that there is a high level of consumer protection in place at EU level.

Mortgage credits should not be subject to a dual legal regime and to a division of law applicable to the mortgage credit contract and law applicable to the collateral contract. There should be a single legal regime. We believe that in the case of mortgage credit, provision of credit is connected to collateral (i.e. real property) so closely that both contracts (credit and collateral) should be subject to the same law, the law of the country where the property is situated -- the principle of “lex rei sitae”.

Our position in this manner derives from the conception of collateral set out in provisions §152 – 174 of the Civil Code. According to those provisions the collateral has a custodial and accessory function, and the origin and persistence of collateral right are inseparably connected with the existence of secured claim (i.e., with the credit). The Czech legal system does not allow a so-called “owners mortgage.”

We believe that conflicts of laws should be regulated in comprehensively within one legal tool, namely, in a revised version of the Rome Convention 1 regulation.

We are aware that the above-mentioned legal regulation and concept is problematic for cross-border mortgage provision. A solution to this could be Euromortgage, in which there would be explicitly stated rules for the provision of cross-border mortgages, also with regard to consumer rights (see also our answer to question No. 30).

3.2 Client Credit-Worthiness

24. 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.

We agree with the approach of the Commission. It is necessary to ensure cross-border access to databases on a non-discriminatory basis and on the principle of reciprocity for the development of cross-border mortgage provision. It would be also useful to harmonize the contents of national databases, especially as regards the kinds of information provided. In the long term, it would be appropriate to create a Pan-European database of debtors with a single access for all the EU member states.

3.3 Property Valuation

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

The question of proper securing (lien) of mortgage loan is crucial from the banking supervision point of view and its faulty resolution could have a negative impact not only on cross-border activity, but also on the stability of the banking system. It is necessary to ensure that the overvaluation of the real property does not occur.

We support adoption of a single EU standard setting out principles of real property valuation for mortgage credits and also a uniform method of certifying valuers, who could publish their evaluations in a publicly accessible database of such valuers (e.g. on the internet). Valuations made according to those standards would be recognized throughout the EU.

3.4 Forced Sales Procedures

27. 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 agree with the approach proposed by the Commission.

Concerns about, in some cases, long, non-transparent and uncertain forced sales procedures are obstacles to mortgage market integration. We agree with the procedure proposed by the Commission since achieving significant

harmonization by way of EU binding legislation in the area of forced sales procedures is unrealistic. It is up to the member states to ensure optimal functioning of the forced sales procedures.

We might further add that currently we are not able to analyze precisely the average duration of forced sales procedures according to the judicial agenda statistics. From the 2004 statistics we can see that the majority of forced sales procedures are legally concluded in 6 months from the petition delivery (81,31%), followed by procedures from 1 – 3 years (8,55%), from 6 months - 1 year (7,15%), from 3 – 5 years (1,87%), from 5 – 7 years (0,62%) and over 7 years (0,5%). There are no special statistical data for the real property forced sales procedures.

Implementation of a complete change of court statistics collection is under way this year. In 2005 we should have more detailed and sophisticated statistics according to single indicators. This also holds true for the average costs of trials and more precisely for real estate forced sales procedures.

3.5 Tax

28. 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.
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In the cost and benefits analysis the Czech Republic was indicated as a country, which through its regulation of income tax exemption on interest rate yields from mortgage bonds discriminates against foreign entities issuing mortgage bonds.

This incompatibility with the EU law will be solved through the amendment of the Income Tax Act, which is currently in the final phase of the legislative procedure. The amendment by its new regulation of income tax exemption on interest rate yields will put mortgage bonds issued according to the Act on Bonds on a equal footing with similar instruments issued abroad. The “similarity” of foreign instruments will be examined in every individual case.

We might further add that home loan providers are not under the impression that there are any tax obstacles concerning mortgage provision in this country.

4. MORTGAGE COLLATERAL

4.1 Land Registers

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

The improvement of the rules regulating land registers is another precondition for mortgage market integration. From a cross-border point of view it is primarily necessary to ensure that the content of those registers is uniform and that their legality is certain. We must also guarantee its credibility, up-to-dateness and transparency. Potential lawsuits and other legal steps which may impugn ownership rights to real property stated in the land register should be recorded there as soon as possible after they develop. Institutions accepting or making decisions about such acts should be required to report to these registers (i.e. mainly courts, notaries, executors, bankruptcy administrators). Remote and easy access to this information should of course be ensured. We support the Commission's activities leading towards achieving those objectives, and we recommend that the Commission continue in its subsidiary role of ensuring further development of the mentioned features of national registers. We also recommend continuing in support of the EULIS project. The return of European investment into those systems should be ensured in particular through differentiable fees for using this supra-national access.

On the national level, in the Czech Republic, banks and other institutions already use a similar system of remote data access. It is fully functional and fulfills its important role. Even as regards fees, this system is cheaper for the consumer than a personal printout picked up from the land register. And we take the liberty of cautioning that in our opinion this project will be successful only if all the member states participate in the same way as in the case of the mortgage credit register.

4.2 Euromortgage

30. 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.

The 26th regime as an entirely parallel regime could be an alternative to purely national mortgage contracts. It would solve certain problems that come up, in particular, with the accessory of the collateral deed. This is why it should be analyzed in further detail. It should not restrict the competitive environment, which is a condition for successful integration.

However, the concept of Euromortgage itself will not solve other obstacles to mortgage market integration. For it to function effectively, it will still be necessary to achieve harmonization in other areas which remove or limit other obstacles and the higher costs of the cross-border mortgage credit provision (e.g., real property valuation standards, forced sales procedures, lend registers and bankruptcy laws).

5. FUNDING OF MORTGAGE CREDIT

We support creation of a secondary mortgage market. However, we believe that the creation of a pan-European secondary market is not possible at an early date, as there are many obstacles and national specifics.

In particular, it is necessary to reinforce standardization of land register administration and data entry in member states and to create a single information system for land registers of different states so that foreign collateral creditors can also have access to information concerning real property in other member states and their liens.

Another thing which needs to be implemented is an acceleration of proceedings concerning collateral in the case of a debtor's non-performance, or alternatively the establishment of an institute of "forfeiture". Furthermore, it is necessary to emphasize that there is currently a divergence in real property valuation in particular member states. This could be removed by setting uniform European legislation for real property valuation.

The possibility of property segregation does not exist in the Czech Republic. Therefore, special purpose vehicle property is a part of the bankruptcy assets of the 100% owner, a situation which weakens the position of the owners of mortgage bonds issued by this SPV and in this way also the rating of these bonds.

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

We fully support the establishment of the expert working group which would analyze the possibilities of cross-border mortgage credit refunding and would deal with the appropriate level of regulation of the mortgage credit providers which are not credit institutions in regard to possible risks and financial stability.

32. 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.

We are open to all initiatives of the market concerning standardization of refunding models. However, we believe that those initiatives should be managed and provided at the EU level to ensure a uniform format for such rules and models. Depending on the level of integration achieved, the optimal models and rules will differ in certain aspects for particular national markets.

33. 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.

Mortgage credit provision should not be restricted only to credit institutions. There are specialized mortgage providers in the Czech Republic. For all these entities (credit providers) the same requirements for credit provision and the same legal regulation must apply.

6. CONCLUSION

Mortgage markets are crucial not only to the whole economy of the member states but also to the EU. It is evident that we cannot at this time speak of a single mortgage market. The European mortgage market has a huge potential. However, it is a very complex and sensitive issue which impinges on many areas and affects the life of everyone and the economy of the whole EU. Therefore, it is necessary to approach this issue with maximum responsibility and on the basis of detailed analyses of particular legislative measures.

We believe that an integrated mortgage market in the EU is feasible and will lead to overall benefits for the economies of the member states and the EU as well. We can see other benefits in the improvement of the competitive environment and in the strengthening of the consumer's position during the shopping-around and signing stage of a mortgage. Particular benefits of other steps will depend on the success in removing obstacles for cross-border functioning of the mortgage market. Although some of the obstacles can be removed by binding EU legislation, many of them are removable only in the long term and with the active involvement of member states during the process of national regulation convergence in areas where effective European regulation is hardly feasible. In some areas it will be necessary to utilize the possibilities of self-regulatory mechanisms for the whole EU.

In conclusion, we would like to add that we were disappointed not to find the issue of definition of mortgage credit in the Green Paper. Single and clear definition is important in order to remove doubts about what European legal proposals are referring to. From our point of view, the definition should contain obligatory characteristics of mortgage loan, for instance security through realty lien (positive definition) and furthermore the characteristics which determine when a loan is not a mortgage loan (negative definition).