

Integration of the markets for mortgage credit in the EU

- Comments on the Green Paper of the European Commission -

A. Comments on the consultation process in general

The German Government shares the EU Commission's opinion that the mortgage credit market is one of the financial services sector's most important sub-sectors with a growth potential. For this reason, the German Government supports the consultations launched by the EU Commission without pre-empting the results of whether there is a need for further integration of the European mortgage credit market. Thus, the decision to set up a Forum Group composed of stakeholder interests and to commission an external cost analysis was generally the right one.

However, the assumption in London Economics report that further steps of integration would result in a 0.7% GDP increase has not yet been sufficiently substantiated. The calculations of potential growth appear to be based on assumptions, and therefore models, which are not plausible without further explanation. The German Government therefore is of the opinion that there as yet no sufficient evidence has been offered to show that integration in the mortgage credit sector would actually bring market actors substantial value added. However, such potential value added is a basic prerequisite for any intervention by the legislative authorities. This view is also shared by the European Commission.

In the event that over the course of the Commission's further consultations it can be legitimately expected that substantial value added will accrue to market actors, the German Government believes that the Commission should take account of the following key points should it decide to implement measures:

Any regulations must be coherent with other relevant regulatory acts, especially with the new Consumer Credit Directive, negotiations on which are currently pending. Divergent regulations would lead to unnecessary bureaucracy in the credit industry and to possible uncertainty on the part of consumers.

The efficiency of the pre-contractual information and the dissemination of the Code of Conduct on home loans must be examined in a neutral and independent manner, as an informed decision on the shape of pre-contractual obligations can only be taken on a firm and reliable basis.

Attempts at market integration by way of product harmonisation, for instance by creating a general legal right of borrowers to early repayment, including in the case of fixed-interest loans, must be rejected because restricting product diversity would be contradictory to the objective of an optimally integrated mortgage credit market.

The European secondary residential mortgage credit market must be strengthened as this will increase the competitiveness of Europe's credit industry.

B. Comments on the questions raised by the Green Paper

I. Assessing the Case for Commission Action

The German government is of the opinion that, as yet, no persuasive proof has been submitted showing the need for legislative action on further mortgage market integration.

The fact that, when formulating its basic position on issues in the field of financial services to consumers, the Commission included the mortgage credit business is welcomed, for a mortgage represents for many people one of the most important banking transactions they will ever make. Of no less importance, however, is the approach repeatedly stressed by Commissioner McCreevy that new regulatory action in this field ought to be taken only where it is clear that the proposed action would have substantial positive implications for market participants. By the same token, his further observations that such an initiative must be based on neutral consultations as well as on strong economic arguments resonate with the German government.

For this reason, the EU Commission's observations in paragraph 4 of the Green Paper that action will be proposed by the Commission after the consultation process only if it is demonstrated that there is a clear business case for Commission intervention in the EU residential mortgage credit markets, i.e., if the potential benefits of intervention can outweigh the anticipated costs of such intervention. In agreement with the basic position the German

government has outlined in its comments on the Forum Group report, the EU Commission also points out that future intervention need not necessarily be of legislative nature.

Another positive element is that the EU Commission has commissioned a study on the pros and cons of integrating Europe's residential mortgage credit markets. But this study, which was prepared by London Economics in August 2005, must be subjected to a critical review. Whilst the German government supports a number of the study's recommendations, some aspects, especially the macroeconomic parts concerning the expected effects, give rise to certain issues which will have to be looked at in more detail over the course of further deliberations. For example, the study's growth potentials are based on assumptions, and thus on models, that would not appear to be very plausible.

The study's very premise for an optimally integrated residential mortgage credit market does not appear very persuasive. It suggests that a mortgage credit market can be deemed optimally integrated when all products are available in all Member States at identical prices. But the mere fact that product prices invariably depend on market-specific, bank-specific and risk-specific factors which, given the structural differences between the various Member State financial markets, are hardly likely to be the same is enough to ensure that prices cannot be identical throughout the EU. After all, loan interest always reflects the respective lender's transformation efficiency as well; it depends, inter alia, on his access to favourable refinancing sources, his risk-management policy, his cost and his market positions. These factors differ among lenders and among markets.

Moreover, there is reason to question whether the calculated GDP growth potential of 0.7% is based on realistic assumptions. The expected macroeconomic leverage effect of an integrated mortgage credit market mainly rests on the assumption that a growing cross-border mortgage business would ultimately result in high growth rates of consumer spending. Increased cross-border business transactions would – according to the study - stimulate the demand for credit and therefore result in growing demand for housing space. This would, in turn, be to the benefit of the construction industry so that ultimately economic growth initiated in this way would, through corresponding impulses, visibly increase consumer spending.

However, the reasons on which these assumptions are based and the way in which they have been quantified are questionable. For instance, the observations on pages 6/7 of the study attempts to prove the validity of the aforementioned "forecast" by pointing out that Spain has seen a growing volume of residential mortgage credit transactions in recent years which has been accompanied by demand for housing space. But the study fails to mention

the real forces behind this growth in demand. Other evidence cited is that, in the opinion of many, the more generous high loan-to-value ratios in Great Britain have resulted in stronger demand for real estate and, as a consequence, in higher property prices (and thus, in a GDP increase). However, the benefit and sustainability of growth generated in this manner would also have to be questioned.

Since the need for regulatory action has not yet been persuasively demonstrated, the comments submitted on sections II to V are done so by way of precaution only. The explanations are subject to the express reservation that such evidence must be provided at a later stage of the procedure.

II. Consumer Protection

In its comments on the Forum Group report, the German government already pointed out that a high measure of consumer confidence is essential if a cross-border mortgage credit market is to be established. The first step towards creating this confidence is to provide potential consumers with all the information they need to informed decisions. But coherence between the consumer protection regulations is also important. Thus, due attention must be paid to ensuring as widely as possible a consensus with current Community law as well as consistency with the new consumer credit directive still to be negotiated.

1. Information

a) Should the Code of Conduct be replaced by binding legislation or remain voluntary?

The German government is of the opinion that this issue cannot be decided upon at the present time.

There is not yet any dependable information on whether and, if so, to what extent this voluntary Code of Conduct provides consumers with the information they need. The study commissioned by the EU Commission in 2003 is of little use in this regard because it was drawn up just shortly after the Code of Conduct came into effect. Intervention by the European legislator should only be considered if the Code's implementation is not satisfactory.

If, at some later stage, a decision is reached to adopt binding regulations on pre-contractual information duties, due care must be shown to ensure that such regulations provide the necessary flexibility to address all relevant situations.

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

The German government shares the EU Commission's opinion that dependable decisions can only be taken by comprehensively informed consumers. But an information overload might turn out to be counterproductive when preventing consumers from taking adequate account of the information that truly matters. Moreover, an information overload would unnecessarily burden the loan provider. As such, it might be prudent for the Commission to examine pre-contractual information duties in terms of their effectiveness in this regard.

In any case, the Code of Conduct represents a good basis for examining whether the credit industry's pre-contractual information duties are adequate. In addition, the aforementioned requirement that the Code must be in agreement with the new consumer credit directive is particularly relevant here. This applies especially to legal systems such as the German one that do not generally distinguish between mortgage-secured loans and other forms of consumer credit.

c) 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 variation in Member States' traditions and legislations?

Different contractual modalities and divergent consumer information needs make it difficult to identify a generally binding stage for meeting specific information duties prior to the signing of contracts. As such, there is a strong case for defining this common EU stage using the same language that has already been adopted for several other relevant regulatory acts of the European Union, i.e. "in good time before the consumer is bound by any credit agreement or offer".

First of all, this timing must be flexible enough to permit consumers to shop around as well as to study and compare terms and conditions without being pressed for time. This is especially important for the desired strengthening of consumer confidence in view of the complexity of

the legal situation, the long lifetime of contracts and the resultant length of consumer commitments including the scope of financial obligations. Secondly, coherence with other European legal acts or planned European legislation is also necessary. The preferred wording is that already used for the Distance Contracts Directive, the Directive on Distance Selling of Financial Services to Consumers and the Commission's modified proposal for a new Consumer Credit Directive.

d) 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?

aa) It is crucial that consumers receive the information they need in good time. It would appear that the issue of whether consumers should obtain this information from brokers or any other third party is of secondary importance. In any event, possible information duties of credit intermediaries should not be set out in special provisions on mortgage credit markets. Instead, they should be contained in a separate directive on credit intermediaries much like the one on insurance intermediaries. Such a directive has already been announced in the EU Commission's Green Paper entitled "Financial Services Policy 2005 to 2010".

bb) From a German perspective, it would generally appear sufficient if non-compliance with pre-contractual information duties is made punishable by consumer organisations and competition authorities. However, the European legislative authorities should abstain from adopting more far-reaching sanctions such as regulations on compensation for damages sustained. On the other hand, there may be some merit in considering whether to release consumers from their contractual obligations where they have not been provided with sufficient information.

In Germany, section 2 of the Injunction Relief Act (Unterlassungsklagengesetz – UKlaG) permits court action to be taken in cases of practices violating consumer protection interests. Consumer organisations, competition authorities and chambers of industry and commerce can avail themselves of this right under section 3 of UKlaG. Moreover, sections 1 and 8 of the Law on unfair competition (Gesetz über den unlauteren Wettbewerb) allow credit providers in addition to the aforementioned organisations to be required by a competitor to discontinue practicing anti-competitive behaviour and (in the event of wilfulness or negligence) to be sued for compensation for damages sustained.

On the other hand, permit credit providers should not derive an advantage from unlawful behaviour. It would therefore appear worthwhile to consider the option of releasing a consumer from his contractual obligations when credit providers have failed to meet their information duties. This could be achieved by adopting the similar concept contained in the Directive on Distance Sales of Financial Services to Consumers. Article 6 of this Directive provides for a right of withdrawal of consumers. However, the period allowed for exercising this right does not begin before the respective consumer has obtained the pre-contractual information. The right of withdrawal extended in Germany in 2002 to include mortgage contracts has proved to be a valuable instrument in consumer protection.

2. Advice provision and loan contract

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

Germany rejects a statutory requirement for creditors to provide advice to borrowers. Consumers are able to take informed decisions after having obtained the pre-contractual and contractual information lenders and credit intermediaries are required to give. It is also recognised that incorrect loan decisions may give rise to high costs for all concerned. Where consumers require advice in addition to the information furnished to them, they are free to ask the credit provider for such advice on the basis of a separate agreement incorporating the corresponding rights and duties.

It must also be borne in mind that making it compulsory for banks to advise consumers would result in higher mortgage loan interest because credit providers would pass on to consumers the additional administrative outlays they would have to shoulder. However, such higher costs would also affect those consumers who have decided against obtaining additional advice, whereas payment for service should only be required from those consumers that have actually enjoyed the benefit of such service.

b) 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)?

aa) It is hardly possible to lay down standards for providing advice. Any such attempt is likely to founder on the different consumer needs in this respect. At most, the creation of minimum

standards to ensure comparability of advice services would be conceivable. However, it would be better to place more trust in the autonomy of private individuals.

Member States' national legal regulations governing the violation of contractual obligations should be applicable to cases of non-compliance with contractual obligations. In Germany, for instance, credit institutions/credit intermediaries may be held liable for damages pursuant to section 280 paragraph 1 of the German Civil Code (BGB). This is an effective sanction in the field of consumer protection. There would appear to be no need for European provisions in this regard.

cc) Credit providers should indicate the fees in advance in order to avoid disputes at a later stage.

dd) Requiring credit providers to record advisory sessions on durable medium would appear to be highly problematic in terms of data protection. This means that credit providers would subsequently have unrestricted access to consumer data. The credit industry would often record such sessions on durable medium in its own best interest. In such a case, adherence to the relevant provisions on data protection would have to be ensured.

3. Early Repayment

a) 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 a right? Under what conditions? Should this right be subject to a compensation in the form of fees?

aa) The German government regards as extremely problematic in terms of consumer protection a legal right for consumers to early repayment of fixed-interest loans. Any such regulation would eliminate, to the detriment of consumers, the favourable effect of fixed-interest loans because credit costs would rise substantially.

(1) Fixed-interest mortgage credits which banks cannot terminate at any given moment without reason are in the interest of consumers. This can be seen from the fact that German borrowers clearly prefer this form of lending. Credit forms that give credit institutions the option of terminating the contract or of adjusting the interest payable are, at contrast, less widely demanded by consumers. By opting for of a fixed-interest loan, the consumer makes

sure that he has the benefit of fixed term rates throughout the lifetime of his credit contract. This protects him against rising interest and gives him planning security.

Banks are faced with the risk of rising interest rates payable on the capital they need for refinancing purposes and, thus, with the risk of increasing costs for obtaining money during the lifetime of credit contracts. To limit this interest variation risk, it is necessary for credit institutions to conduct the deposit business at fixed rates of interest in order to “close” their initially “open” interest position. To this end, eligible forms of refinancing are mortgage backed securities (Pfandbriefe) (up to 60% of the mortgage lending value of the property financed or otherwise surrendered by way of security), uncovered bearer bonds as well as credit balances under building-saving contracts which as a rule are subject to fixed interest rate payment. Were consumers to be given a simultaneous right to terminate their loan contracts and/or to require interest rate adjustment at any given moment, this would mean the risk of interest fluctuations which credit institutions could not accept. Consumers would exercise their right to terminate their loan contracts when interest rates fall. Banks would have to accept this and to borrow again the funds repaid, though now at terms and conditions less favourable than before. Since they are required to pay fixed interest rates in their deposit business, it would be initially impossible for them to avoid potential losses of interest. This situation could only be remedied if banks also had the right to terminate refinancing transactions on their part at any given moment. But this would be the end of all long-term financing options currently on offer and wished for by consumers in Germany. If, on the other hand, the right of contract termination/adjustment at any given moment were to be unilaterally reserved for final consumers alone, credit institutions would only offer corresponding fixed-interest deals subject to the payment of a considerable premium in order to take account of the above-described option risk.

(2) The exclusion of a consumer right to terminate his fixed-interest credit contracts at any given time without a relevant reason need not be to his detriment or tie him to his bank for an unduly long period of time. Section 490 paragraph 2, first sentence, of the German Civil Code, for instance, offers borrowers of fixed-interest loans adequate possibilities for serving notice of termination. Borrowers have a legally regulated right to terminate their loan contracts when the agreed fixed-interest period has lapsed or after ten years at the latest. Moreover, where an important reason exists, consumers may be permitted to repay their loans early subject to the payment of a penalty.

(3) From the point of view of consumer protection, it is sufficient to allow consumers to choose between generally non-terminable fixed-interest loans or potentially more expensive

floating interest mortgage loans. The latter would allow consumers to benefit from falling rates of interest, for instance. Besides, under floating-interest mortgage loan contracts consumers can generally hedge against the risk of rising interest rates by paying an option premium determined by changes in the credit institution's refinancing structure (option costs of the credit institution and/or more short-term and thus more costly refinancing) as well as its administrative outlays. A corresponding choice and combination of contracts enable the borrower to control his risks individually and mean that he can respond to, and therefore benefit from, falling interest rates. But as was mentioned before, German consumers seldom wish to conclude floating interest rate contracts.

For consumer protection purposes, there is therefore no need to introduce a binding regulation, since this would make it noticeably more difficult for borrowers to obtain fixed-interest loans. Such a restriction on product diversity conflicts with the concept of an optimally integrated market and cannot be justified on objective grounds. This view is supported in the study by London Economics. It also sees the widest possible product diversity and availability as the greatest value added of a fully integrated European mortgage credit market. In macroeconomic terms, the diversity and availability of products was identified as the main driving force for future growth potential of integrated markets.

bb) Borrowers must be able to waive the possibility of early loan repayment. In principle, choosing a fixed interest rate contract automatically means that early repayment is not possible. This waiver should not be subjected to conditions.

cc) Where fixed-interest loans are repaid ahead of time, credit providers must legally be entitled to full compensation for resulting losses.

However, it must be pointed out that the introduction of a clause allowing consumers to terminate mortgage loan contracts at any given moment would still appear barely reconcilable with the requirements of mortgage credits congruently refinanced via Pfandbrief even where the bank's refinancing losses could be fully compensated for by way of an early repayment fee. The interest congruency principle means that the total amount of Pfandbriefe in circulation must be covered up to their nominal value by mortgage loans generating interest earnings that are at least equal in amount. The interest congruency requirement would be violated where after massive waves of loan repayment or debt rescheduling new loan contracts could only be concluded at interest rates that are distinctly lower interest rates well below the coupons of the old Pfandbriefe. For the cash funds accruing to the bank from

early repayment including early repayment fees do not meet the legal requirement of interest congruency.

b) 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?

Where generally – which Germany rejects – or for an important reason a consumer is allowed to terminate his mortgage credit contract early, under no circumstances is this to lead to losses for the lender. For this reason, premature fixed-interest loan repayment would have to be tied to a corresponding regulation on early repayment fees.

aa) In 2002, the Germany codified the right of lenders to demand early repayment fees to be paid pursuant to section 490(2), third sentence, of the Civil Code (BGB). The German lawmakers deliberately left it to the courts to determine how the amount of such compensation is arrived at, the ramifications and details of which defy being codified in law and must remain open to potential adjustment required by structural changes in external economic conditions. This has proved a wise decision.

bb) Germany rejects the idea of fixing caps on or flat rates for damage compensation below the lender's actual performance interest. Limited compensation regimes would be to the detriment of lenders. Credit providers, on the other hand, would have to socialise the costs of potential damage, i.e. to allocate these costs to all mortgage credit consumers by introducing tougher terms and conditions in line with the expected damage, and they would have to do so independently of whether or not a consumer would wish to exercise his right to early loan repayment. Such tougher terms and conditions would be to the detriment also of those consumers who behave in agreement with the loan contract. This would not be acceptable.

Finally, developments in other EU Member States have shown that models for limiting compensation may lead to shifts in market shares which are not in the best interest of consumers. Fixed-interest mortgage credit would be chiefly affected. In Spain and Portugal, for instance, exclusively floating-interest loans have been on offer for some time because caps on early repayment fees have completely crowded fixed-interest credit out from the market. In periods of rising interest rates, however, the fact that fixed-interest loans are simply not on offer may mean that borrowers are unable to meet their interest payment obligations. Such a development cannot be in the interest of consumer protection. Nor can crowding out fixed-interest credit be desirable in terms of macroeconomic policy.

c) How should consumers be informed about early repayment? Is there scope for consumer education here?

Credit providers are required to inform consumers extensively about the profile of the respective loan on offer and on the modalities relating to early termination of the financing arrangement at the time of offering to enter into a credit agreement with a consumer. This is necessary, as consumer information has an important role to play in a fully integrated market which is characterised by a wide-range of product diversity.

Of course it is not possible for credit institutions at the time of signing a credit agreement with a consumer to inform him about the exact amount he would have to pay in terms of penalty for premature loan repayment because the level of compensation depends on a variety of factors (e.g. the rate of interest actually payable at the time notice is served), which are not known at that point in time. The Standardised European Information Sheet developed within the framework of the Code of Conduct for home loans provides for reference to be made to the legal situation with regard to early loan repayment. It would have to be examined whether a system whereby standardised and typical model calculations could be used to inform the consumer in advance of the possible extent of any later early repayment fees could be of benefit to the consumer.

bb) The concept of consumer education appears to be unclear. There is no need to “educate” consumers. Rather, they must be enabled to make informed decisions by providing them with comprehensive information.

4. Annual Percentage Rate of Charge (APRC)

a) What is the purpose of an APRC? Information? Comparison? Both?

It would be fair to assume that in a European context the annual percentage rate of charge clearly serves the purpose of comparability, even though it may be expected to meet information needs as well. The APRC is intended to enable consumers to compare more easily the prices of credit offers received from different countries. To this end, it would also appear prudent to standardise EU-wide the cost elements that should be included in the annual percentage rate of charge for mortgage credit.

b) Should there be an EU standard covering both the calculation method and the cost elements?

Germany would generally welcome an EU standard covering the basis and method of APRC calculation. However, standardisation would have to be coherent with the corresponding regulations of the consumer credit directive. Different calculation methods must be avoided at all costs. Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit has largely harmonised the APRC calculation method. Since this Directive must be presumed to also apply to mortgage credit in most Member States, the need for a special regulation cannot be recognised. A special regulation could result in barely solvable problems of definition as well as in unjustifiable outlays by the credit industry.

c) If so, what kinds of cost elements should such an EU standard include?

Comparability must be the decisive factor in whether or not a cost element is included since – as mentioned above – it is the main purpose of the annual percentage rate of charge to make it easier for consumers to compare different credit offers.

Since cost profiles differ widely throughout the EU, close definitions are needed for the APRC cost elements. Otherwise it would probably not be possible to ensure the comparability of credit offers. It ought to be noted in this context that the European Commission has pursued this approach through its modified proposal for a new consumer credit directive. This explains why - as in the case of the new consumer protection directive - only such cost elements should be included in the APRC calculation as are caused or controlled by credit providers and are already known at the time of credit agreement conclusion.

In Germany, the costs to be included in the annual percentage rate of charge calculation are subject to the provisions of the Price Indication Ordinance (Preisangabenverordnung). Since mortgage credit is based on fixed annual repayment amounts, these elements would, by way of example, be handling charges or compulsory residual debt insurance in addition to interest and redemption rate calculations. Other cost elements, by contrast, such as notary-public

and land-register entry fees as well as the premiums payable under any capital life insurance contract concluded for purposes of loan repayment at a later stage should probably have to be excluded from APRC calculations because they are simply not known to credit institutions. The mere existence of this type of cost should therefore be mentioned.

d) 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.

Separately mentioning specific figures for the costs credit providers have not caused and are thus unaware of would not appear prudent. However, credit providers should mention to consumers the existence of several types of third-party costs (e.g. notary-public fees and land-register entry costs, brokerage commissions as well as insurance premiums where insurance is not required for obtaining the loan) so as to enable consumers to identify these types of costs themselves.

5. Usury rules and interest rate variation

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

We are unaware that market integration has been hindered by any lack of European rules on usury control. The European Commission would therefore have to prove that rules on usury control would result in clear improvements before deciding to intervene.

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

Germany would not be able to support any specific regime on usury control because such a regime would not be flexible enough.

In Germany there is autonomous legal regulation specifically designed to prevent excessive interest rates from being charged. Under German law, cases of usury rates rendering contracts invalid and constituting a reason for taking credit providers to court on grounds of having committed criminal offences are deemed to exist in cases of remarkable imbalance.

In case law, contractually agreed rates of interest that are at least 100% more than the level of the interest payable in the market for an identical type of credit are null and void. This flexible approach has proven worthwhile.

c) Do such restrictions (on cumulative interest) hinder market integration?

There is no information here suggesting that such restrictions have impeded market integration.

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

No information on this point is available.

6. Credit Contract

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

Germany supports the standardisation of mortgage credit agreements only insofar as this exclusively serves to improve the comparability of product descriptions from a consumer point of view. By contrast, Germany would have to reject any standardisation of mortgage contracts which would limit product diversity.

The option of introducing a 26th regime would have to be examined very closely. One advantage would certainly be that loan products would be more readily comparable. However, contradictions and inconsistencies to non-harmonised national regulations that are applied in a supplementary context would have to be avoided.

7. Enforcement and Redress

a) 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?

There would appear to be no need at present to make it compulsory for Member States to provide for alternative dispute settlement procedures in the field of mortgage credit. There already exist sufficient Community-wide mechanisms for the extra-judicial settlement of disputes, particularly now in the cross-border matters.

The FIN – NET, representing a cross-border network for handling complaints out of court, can be mentioned in this context with respect to financial services. It is similar in structure and activity to the EEJ – Net (EEC Net) created for settling general disputes faced by consumers (co-financed by the German government). FIN – NET represents an association of Member States bodies responsible for settling disputes in the financial services sector (the German banks' ombudsmen). It is one of this network's tasks to inform consumers of dispute settlement possibilities. Members of NET are in contact with each other channelling potential complaints to the respective foreign dispute settlement body. All settlement bodies having joined to form this network on the basis of the Commission's Recommendation of 30 March 1998 (98/257/EC) specifying the seven principles that relate to extra-judicial settlement of disputes faced by consumers (independence, transparency, adversarial, effectiveness, legality, liberty and representation).

In light of the above, the German government does not see any need to create new forms of organisation especially for the mortgage credit sector. But there might be some merit in examining whether all EU Member States (including the new ones) have created such structures already.

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

Reference must again be made in this context to the aforementioned Recommendation from the EU Commission dated 30 March 1998 (98/257/EC). Germany does not see the need for further intervention by the Commission to improve the trustworthiness of and/or consumer confidence in the existing dispute settlement procedures.

III. Legal Issues

1. Applicable law

Germany expressly welcomes the fact that the Commission intends to abstain from including international private law provisions in any future legal instrument relating to mortgage credits. The reason for this is that the 1980 Rome Convention, which governs the determination of the law applicable to credit contracts and contracts on the real rights to property is currently undergoing a revision process with the aim of transforming it into an EU Regulation.

The Green Paper further proposes a review of the law applicable to mortgage credit as well when bringing the Rome Convention within the Community framework. The German government also supports this suggestion. The three options provided for by the Green Paper in this regard must still be evaluated in detail, but appear to be justifiable as a working hypothesis.

Germany welcomes the fact that the Green Paper ultimately opts in favour of applying the *lex rei sitae* principles when reaching a decision on the law that shall be applicable to the collateral.

2. Client Credit-worthiness

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.

On the issue of whether credit providers should have access to national databases, the German Government also subscribes to the Commission's view that coherence with any new consumer credit directive is indispensable. The approach of non-discriminatory access is supported as a matter of principle. However, consumers' data protection needs must be accounted for appropriately.

The Commission is right in pointing out that data protection is of great importance in respect of data collections for the purposes of evaluating the credit-worthiness of consumers. Problems mainly tend to arise in practice where false or obsolete data have been stored or where data about individuals is confused. This risk grows as the volume of data stored

increases. When examining whether or not to adopt measures for creating and shaping such non-discriminatory access to databases, it is necessary to ensure that the database quality is not impaired and that the risk of confusing data relating to the identity of borrowers does not increase. This applies to mortgage credit in particular as assessing the credit-worthiness of consumers is less important in the field of mortgage credit – than it is, for example, in the case of consumer credit – because of the associated collateral.

3. Property Valuation

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

The German Government rejects the idea of having a single EU standard both for valuation processes and for valuers. For instance, when refinancing mortgage loans using Pfandbriefe, consumer protection interests make it necessary to retain the strict standard of loan-to-value ratio legally regulated in Germany and known to EU bodies as well, which means that a single EU standard, if any, would have to take account of this ratio.

The loan-to-value ratio of real property that is to be ascertained pursuant to the German law on Pfandbriefe (Pfandbriefgesetz) serves to protect the Pfandbriefe issued for the purpose of refinancing mortgage loans in the capital market. With a view to safeguarding the claims of Pfandbrief creditors, it is necessary for issuers of such securities to include the real rights so acquired in a specially protected cover pool of mortgage loans. It should be noted in this context that real right issuers are required to use for inclusion in the cover pool not more than 60% of the loan-to-value ratio of the real property aimed at sustainable development so that this value must be ascertained with special caution. If the level of security enjoyed by Pfandbriefe were impaired by placing in the cover pool a value deemed to be legally equal under EU law, instead of a real property amount ascertained in accordance with the loan-to-value ratio, it would only be possible to issue such Pfandbriefe at a higher level of interest. As a result, mortgage-backed securities would rise in prices as well. This would not be in the interest of borrowers.

Insofar as the idea is to adopt several uniform valuation standards in each field of application, it should be left to market forces to develop such standards already organised at the EU level.

b) What are the merits of Commission action to ensure mutual recognition of national valuation standards?

Any compulsory mutual recognition of national valuation standards within the EU would entail substantial drawbacks for consumers and for the German credit industry and cannot, for this reason, be supported by the German Government.

Such recognition must be presumed to result in a situation in which banks issuing Pfandbriefe would prefer to acquire mortgage credit claims from Member States applying less strict valuation yardsticks formally declared equal to the provisions of the German law on Pfandbriefe and to meet their refinancing needs in this way. The cover pool volume would tend to grow and would enable banks issuing Pfandbriefe to expand their issue volumes.

However, consumers in Germany would be adversely affected in two ways. First, mortgage credit would presumably become more expensive because the Pfandbriefe used for refinancing purposes would be deemed to be less secure and would themselves becoming more expensive. Second, German mortgage credit providers might be forced to increasingly rely on other less favourable refinancing sources.

The Forum Group on Mortgage Credit consider a recommendation in its report regarding an approximation of valuation processes as a measure of the EU Commission. Insofar as the EU Commission plans to pave the way for intervention in the field of valuation processes at the EU level in spite of the existing opposition, a recommendation might be a viable option.

The compulsory mutual recognition of expert opinions would not appear to be unproblematic either, because such opinions are expected to meet specific requirements within the framework of the valuation process although they have been commissioned to provide independent expertise. Any expert opinion would have to be dismissed at all costs which has not been commissioned for the specific purpose of ascertaining the loan-to-value ratio of real property, but which reaches the conclusion that it forms an appropriate legal basis itself for assessing the respective loan-to-value ratio in light of the fact that the relevant EU law provisions have been deemed to be equal and legitimate.

On the other hand, it is possible to support the proposal for mutual recognition of expert qualifications. This would presuppose that experts submit evidence of their qualifications which show that they possess the necessary expert knowledge about market conditions,

types of property, specific lending purposes (e.g. loan-to-value ratio assessment under the German law on Pfandbriefe) etc.

Finally, it must be pointed out that the conclusions of the London Economics Study (cf. pp. 78 ff.) on the harmonisation of valuation processes are problematic. The Study's unsubstantiated view that the reasons for nationally adopted valuation standards simply reflect historical developments and that potentially existing procedural differences are of no economic importance must be deemed to be incorrect in light of the above-mentioned considerations about valuation processes.

It is correct that the standardisation of the process would obviously deprive credit institutions of their advantage in terms of their knowledge of the legal situation prevailing in their country. But it is incomprehensible that standardisation should be regarded as the only appropriate instrument for eliminating, to the benefit of consumers, the overt practice in individual Member States of overvaluing real property. Instead, the above comments on the loan-to-value ratio of real property prove that precisely the contrary is correct, namely that special market conditions may pose a need for special valuation processes including nationally independent ones, where appropriate.

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 German Government generally supports the Commission's proposal for forced sales procedures.

This item must be seen in a context with the Commission's plan entitled "Improving Enforcement of Judicial Decisions". This plan deals with possible steps towards the harmonisation of forced sales procedures. The Green Paper prepared in this regard has already provided extremely valuable information about the diversity and common features of European legal systems. The White Paper recently announced by the Commission could provide the necessary information about the situation in Germany as well as in other Member States.

A similarly high level of information might be expected from the Commission's existing proposal for forced sales procedures.

However, there are questions, at least as far as Germany is concerned, about the method and sources the Commission uses to obtain the information and about the sources on which the Commission intends to rely when preparing the regularly updated 'scoreboard'. To our knowledge, national statistics on forced sales procedures are at best rudimentary in Germany. Plans, if any, to use mortgage bank data would not be without problems from a legal perspective.

There is no general answer as to whether and to what extent it would be possible and useful to make a modest start to EU harmonisation in the field of forced sales procedures. In any event, the German law on forced sales procedures represents a largely self-contained law area pursuant to the Act on forced sales procedures (Zwangsvorsteigerungsgesetz), and barely permits isolated adjustment or modification.

5. Tax

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 tax law.

There are no tax regulations in Germany that subject mortgage interest payable to foreign nationals to tax treatment that is different or less favourable than the treatment accorded to German nationals in respect of comparable payments.

IV. Mortgage Collateral

1. Land Registers

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

a) Paragraph 44

A land register system must ensure that it can be easily inspected for information about existing real property rights. This has been ensured under German law. According to Section 873 subsection 1 of the German Civil Code (Bürgerliches Gesetzbuch – BGB), any land-register entry means that a real right has been constituted. Conversely, no real property right exists without a register entry. This applies to any kind of collateral right in real property.

Only in rare exceptional cases could a mortgage be constituted without a land register entry. For instance, a debt-securing mortgage (property as collateral) must be deemed to have been constituted where a title evidencing the ownership of the real property transferred has been pledged and where the underlying claim is subsequently satisfied (Section 1287 sentence 2 of the BGB). However, even in such rare cases, a third party may rest assured that the information the land register provides is correct as long as this third party has not been informed to the contrary (bona fide regulation) (cf. sections 891 et seqq. of the BGB).

Access to land registers is easy in Germany. Automated procedures regulated by Section 133 of the Land Register Ordinance (Grundbuchordnung – GBO) have been installed to this end. Although German law stipulates for reasons of data privacy that access to land registers is only granted where a legitimate interest can be proven (sections 12 and, 133 of the GBO), this stipulation is of no relevance in the field of credit financing, because owners are naturally free to inspect land registers at any time or to give credit institutions permission to do so.

b) Paragraphs 45 and 46

It does not necessary at the present time for the European Union to continue to finance projects such as EULIS.

2. Euromortgage

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.

It must first be examined whether the European Union has the competence for regulating what are not strictly European accessory real rights (Euromortgage). This might well be doubted. Only after this question has been unambiguously affirmed, would it be recommendable, as a first step, to measure, both nationally and internationally, the economic

advantages and disadvantages associated with a Euromortgage (impact study). Apart from this, several other aspects must be taken into account as well:

The aim of facilitating cross-border investment can only be achieved if the Euromortgage is designed as a non-accessory security instrument. Germany's experience with the land charge show that such real rights are much easier for credit providers to handle and thus simplify the process of providing security. In particular, such encumbrances make it possible to secure debts varying in amount, to exchange secured debts, to secure several debts through a single encumbrance and/or to secure a single debt through several encumbrances. Once a credit contract has expired, the encumbrance can be used as security for another, new established debt. It is even possible to secure non-monetary debts.

However, this loose accessoriness must not be allowed to create disadvantages for collateral providers. As distinct from the strictly accessory security interest, it is necessary in the case of the non-accessory encumbrance to prevent the collateral provider from being deprived of his real property although he has paid off the underlying debt in full. This danger is especially acute where the land charge is transferred to a new creditor, either together with or separate from the secured debt. The Euromortgage must therefore be designed in such a way as to ensure that it is possible to bring forward legal objections not only with respect to the secured debt, but also with respect to the encumbrance.

Any European regulation on the Euromortgage must be confined to a few principles, and it must be left to Member State governments to regulate legal details. Since the implications of encumbrances are relevant not only for the law of property, but for a number of other regulatory fields as well (such as the law on land-registers, forced sales procedures, insolvency, banking, Pfandbriefe and insurance), the Commission should abstain from excessive harmonisation at the European level. Otherwise, Member State governments would largely be deprived of much of the scope they have for designing products.

The fact that the Euromortgage will only be realised as part of a "26th regime" does not rule out implications for law making at national level either. Since it constitutes a collateral right in real property, the Euromortgage also has implications for third parties. A simple "inter partes" agreement is not a viable option in this legal area as distinct from property law.

V. Funding of Mortgage Credits

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.

Developing an efficient and liquid capital market for mortgage credit and mortgage credit refinancing may be central to the successful integration of EU mortgage credit markets.

Contrary to the primary market, a well-developed secondary market combined with efficient mortgage refinancing mechanisms offers far greater potential for integration that can also be used without requiring a change in the system. For this reason, the German Government supports the EU Commission's suggestion that a working group should be established to examine the necessity for intervention in this area and, if so, what the nature of such intervention should be.

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.

Gains in efficiency to the direct benefit of consumers are obtainable by facilitating risk diversification through the creation of efficient secondary mortgage credit markets, the optimisation of refinancing terms and the improvement of capital allocation (proofing Pfandbriefe as well as special-purpose associations for issuing mortgage-backed securities against insolvency, mortgage credits as detachable special bank funds etc.). In this context, the German Government also supports uniform rules on evidence of ownership in cross-border sales of credit claims and securities. However, such rules must not be allowed to limit the diversity of products.

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 definitions of a credit institution and therefore of all related prudential rules.

Germany rejects any idea that would permit mortgage loans to be extended by institutions not or not fully subject to the law on the supervision of financial services.

The highly varied supervisory provisions safeguard a high standard for the lending business of banks, insurance companies and building societies. This high standard is in the interest of consumer protection as well. Moreover, substantial distortions of competition would arise if market participants not subject to the strict supervisory rules were able to grant mortgage credits as well.