

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

INTRODUCTION

The following is the joint response of the Department of Finance and the Irish Financial Services Regulatory Authority (the Financial Regulator). The Financial Regulator is the competent authority in Ireland for the authorisation, supervision and regulation of almost all mortgage lenders and all mortgage intermediaries.

Ireland welcomes the Commission's Green Paper and the additional information it provides as to the Commission's approach to this topic. Ireland reiterates its belief that the focus of the process should be on integration of the mortgage credit market and options other than legislation should be thoroughly examined. Proposals for intervention need to be tested in terms of their necessity and economic advantage; we do not agree with regulation for its own sake. Given the variety of recommendations and the range of practices in Member States, there may be limited scope for EU Commission intervention in the form of new legislation. Advisory initiatives and cross-border co-operation on a voluntary basis may constitute a more rational approach in some areas and regulatory intervention should be undertaken only after a rigorous regulatory impact assessment. We would also like to emphasise the fact that there is scope for cross-border lending in the mortgage market at present, through both passporting and cross-border mergers and acquisitions between lending institutions.

Ireland also welcomes the Commission's recognition of the cost/benefit considerations to this issue and the publication of the LECG report into this matter. However, we are concerned that the considerable benefits to which the report refers are based on assumptions such as, for example, that existing legal restrictions which limit product availability in certain markets would be removed. Ireland possesses a well-developed market in mortgage products and consequently the assumptions regarding the potential benefits of mortgage integration are more limited in Ireland's case, due to lesser scope for additionality.

SPECIFIC RESPONSES TO THE QUESTIONS CONTAINED IN THE CONSULTATION PAPER

SECTION II – CONSUMER PROTECTION

Question

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

Response

Ireland considers that the European Standardised Information Sheet (ESIS) has gone some way in creating a more open and transparent approach to the offering of mortgage credit and there is a high level of application of the Code of Conduct in the Irish market. The Code is used extensively in the Irish market with lenders obliged to supply equivalent but not identical information. A harmonised legal provision would eliminate this overlap.

While Ireland considers that ESIS is very good in principle its weakness is its voluntary nature and the fact that compliance is not backed up by a sanctions regime. For this reason Ireland believes that the code should be replaced by more formal arrangements.

Question

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

Response

Ireland agrees that a balance must be found regarding information provision and suggests that the mortgage letter offer should capture all the costs applicable to the loan – costs that the consumer will or might have to pay depending on what happens over the life of the loan – for example:

- If I decide to pay off this loan early – what costs will be applied to the early repayment?
- If I fall into arrears- how will interest be applied to the arrears?
- If I fall into arrears what legal costs will I have to pay? Etc

Ireland suggests that financial institutions be urged to use plain language in their disclosures to consumers.

Question

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 legislation?

Response

A fundamental element promoting consumer awareness is to encourage consumers to shop around. Ireland agrees that the provision of pre-contractual information to consumers enables them to shop around more effectively.

It may be difficult to ensure that all of the ESIS-type information is provided at the "shopping-around" stage. The relevant information should certainly be incorporated into the mortgage offer letter. While the ESIS can be a valuable tool for comparative purposes, other methods of standardizing information provision should also be considered so as to make the 'shopping around' process as efficient as possible for the consumer. One possibility would be to require mortgage lenders to make this information available on their websites.

Question

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?

Response

Ireland believes that an information provision regime should apply to brokers also. All information given to consumers, regardless of whether it comes from a financial institution or a broker, should be in the same format and should be given at the same time.

Consideration should also be given to some broker-specific disclosure requirements on matters such as:

- The scope of the market search performed by the broker, and

- The commissions paid by the mortgage provider to the broker.

Compliance could be promoted through a monitoring (including mystery shopping) and inspection regime, backed up by a formal sanctions process.

Question

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

Response

It is not clear if the Commission is referring to advice in relation to the most suitable mortgage product available in the market or merely advice on whether or not a given product is suitable to the needs of the consumer. Obviously a lender can only advise in relation to the suitability of their own products. Greater clarity on the nature of advice to be prescribed would be required before Ireland could offer a definitive view on a duty to advise.

However, Ireland is moving towards a policy that consumers should receive financial advice when taking out a mortgage unless the consumer confirms in writing to the firm that he/she does not wish to be advised. Firms should be required to maintain records of such confirmations. The key to an effective provision in relation to this matter will be to arrive at a useful definition of advice, particularly an unambiguous understanding of the difference(s) between information and advice.

Question

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)?

Response

Ireland considers that any advice given should be of a required standard and that the conditions applied should encompass all of the factors cited in the question.

Question

Should an early repayment be a legal right or a matter of choice? If it is to be a right, should it also be made possible for a consumer to waive this right? Under what conditions? Should this right be subject to a compensation in the form of fees?

Response

Early repayment of loans is a legal right in Ireland with compensation for lenders only permitted in respect of fixed rate loans, during the fixed rate period. It would be extremely difficult to revoke this well-established right but Ireland accepts that early repayment of fixed rate loans may impose refinancing and administration costs on the lenders. However, any compensation fees should be clearly explained and laid out in advance of the conclusion of the contract. In the case of a variable rate loan there should be no refinancing costs applicable.

Question

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?

Response

Ireland suggests that early repayment fees should be calculated in a manner that reflects the real cost to the institution of redeeming the loan early. Early repayment fees should not be a profit centre for lenders.

Question

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

Response

This disclosure should occur at the mortgage offer letter stage – through the ESIS - and before the consumer enters into the contract.

Question

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

Response

Ireland considers that APR is mainly used for comparison purposes. It captures all the costs that the consumer will have to pay in order to draw down the loan. APR itself is not well understood by consumers, and they may not understand why the annual interest rate and the APR applied to a loan can be different.

Question

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

Response

Cross border shopping for mortgages would be made very difficult if different methods of calculating APR applied in different jurisdictions. We therefore consider that an EU standard is desirable as it will assist in the comparability of the cost of mortgages.

Recommendation

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

Response

Ireland suggests that any such EU standard should be designed to capture all costs that the consumer is expected to pay in order to draw down the loan but exclude any costs which are outside the direct control of the mortgage lender. This would inevitably be a challenging task, and perhaps a draft model could be circulated to industry and consumer bodies, and to regulators, for comment.

Question

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 cost per month or the overall cost of the loan.

Response

While it would be beneficial for lenders to draw attention to all costs not specified in the APR, in considering what additional disclosure is merited cognisance must be taken of the possibility of information overload for consumers, and in particular the prominence that such additional information might be given relative to the APR figure.

If you have a standard ESIS format across the board, then information presented to consumers should be in that format – this will make it easy for consumers to compare different offers because they have taken the same format and approach. The ESIS should show the nature and amounts, if known, of one-off and recurring charges associated with the loan, which are not included in the APR.

We believe that there may be merit in also showing the APR figure in terms of cost per month, as this is a figure that will be meaningful, in terms of budgeting, for consumers.

Question

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

Response

Ireland does not maintain such rules and believes lenders should be free to let the risk determine the rate applied and that such caps are not necessary in a functioning competitive market. Furthermore, the difficulty in accurately assessing risks is one of the key obstacles to cross-border lending and this difficulty will be amplified if lenders are not free to apply the rates they believe necessary. A competitive market, together with an appropriate degree of price transparency, should be adequate to protect consumers.

Question

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

Response

In the light of our above response, this matter should also be considered in the context of consumer credit.

Question

Do such restrictions hinder market integration?

Response

On the face of it such restrictions operated at the national level could hinder market integration.

Question

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

Response

Restrictions on the application of compound interest rates could tend to push consumers who wish to use some of the equity in their home to consider contracts for home reversion schemes rather than equity release loans.

Question

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

Response

The standardisation of mortgage deeds and contracts is currently being considered within the Irish market and Ireland considers that the idea of a 26th regime is worth evaluating. However, the additional costs and benefits that a 26th regime would impose on industry, consumers and regulators would need to be carefully evaluated. Contracts governed by the 26th regime would need, at a minimum, to offer protections for consumers similar to those currently enjoyed. It also remains unclear as to how such a regime would operate in practice, particularly in how it would interact with existing legal structures.

Question

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?

Response

Redress issues could be dealt with by National Financial Ombudsmans (or such other offices as may be relevant in Member States). Ireland has recently established a statutory Financial Services Ombudsman Scheme which provides such an alternative means of redress in the mortgage credit area. It would be necessary to ensure that the entities operating such redress mechanisms have similar mandates and procedures in order to ensure equivalent treatment of complaints.

Question

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

Response

No Comment.

SECTION III – LEGAL ISSUES**Applicable Law**

As the Rome Convention has wide ranging implications across a number of sectors, Ireland requires more time to consider this issue. The solution will need to provide a high degree of legal certainty in order to ensure industry and consumer confidence. Any difficulties are amplified by the fact that mortgages impinge upon aspects of a number of other areas of law, such as property, consumer credit, banking and family law.

Question

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.

Response

Ireland welcomes the Commission's intention to adopt the same approach as for consumer credit on this issue, which is integral to the integration of consumer credit and mortgage markets. In order to participate in a mortgage market, access to data allowing verification of a potential customer's credit history is essential. If access is not allowed it could result in poor credit decisions. Ireland believes, therefore, that cross-border access to databases is necessary. However, if institutions wish to operate in a market they have to be prepared to meet an appropriate proportion of the costs of maintaining the database.

Greater clarity is required as to how non-discriminatory access for foreign lenders would manifest itself. It would not be appropriate for the costs of accessing an existing database to be so prohibitive that they represent a barrier to entry to that

market place. It should also be recognised however that institutions need to have sufficient resources to join and contribute to an existing database system, and to invest in the systems necessary, in order that the credibility of the database is not diluted. [In other words – they do not just draw from the well, they must also contribute to it.]

Question

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

Response

Effective property valuation is obviously a crucial element if credit institutions are to be tempted into cross-border lending. However, it is our understanding that valuation methods differ widely in other Member States where the rental market is more developed than in Ireland and valuations are related to rental income. A standardised approach would have to be appropriate in the context of the varying housing market characteristics of Member States. It remains difficult to envisage how any harmonisation of valuation standards would practically overcome informational asymmetries and the need for local knowledge of the housing market.

Question

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

Response

Due to the differing characteristics of housing markets and valuing traditions in Member States, mutual recognition will require that lenders accept valuations methods which may not be appropriate to their own lending criteria.

Question

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.

Response

While forced sale procedures represent another variable crucial to lenders’ assessments of the risks involved in cross-border lending, this also represents an area of considerable political sensitivity. This being the case, Ireland welcomes the Commission’s gradual approach in this area. Without prejudice to any proposals that may emerge, Ireland acknowledges that this is an important and complex issue, and endorses the Commission’s proposal to commence with an information gathering exercise. Further thought on this aspect of the Green Paper will be possible when the results are available. It may also be necessary to examine the practice and procedures developed in the Member States’ markets that would apply prior to the use of a forced sale procedure.

Question

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.

Response

There are no tax obstacles to the provision of cross-border mortgages into Ireland with tax relief on mortgage interest available to borrowers regardless of the location of their lender.

SECTION IV – MORTGAGE COLLATERAL

Question

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

Response

The Irish title registration system meets the requirements set out in paragraphs 30 to 33 of the Forum Group recommendations and generally speaking, the registers maintained under the system reflect all charges. An e-conveyancing project is underway which should assist in the efficiency, transparency and accuracy of Irish property registers. An understanding of the content and operation of the various land registers would be essential for cross border lending. There would seem to be clear merit in some form of agreement regarding registration systems across the EU in view of the centrality of land registers to the operation of property markets in all Member States. This centrality will become more evident (and necessary) as progress towards e-conveyancing in Member States accelerates. The land registration systems in Ireland operate on a self-financing basis and there appears to be no reason why this should not continue. However, a pan-European approach in this area could result in significant social and economic gains. Moves towards convergence, as with the EULIS project, should continue to be supported and encouraged by the Commission.

Question

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

Response

There is no reason in principle why a mortgage deed capable of registration in the Irish land registers cannot be prepared in other Member States or why consideration could not be given to a common EU parallel instrument option for the parties without substituting national rules. While there may be some difficulties such as national family law requirements to be overcome, these should not prove insurmountable.

In principle Ireland considers that the concept of a Euromortgage could contribute to the promotion of a single mortgage market. We note that the Commission will review this issue and we will await the Commission's findings in this regard.

SECTION V – FUNDING OF MORTGAGE CREDIT

Question

- 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.
- 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.

Response

Ireland supports the Commission's initiative to create a stakeholders' working group to examine this issue.

Question

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 therefore of all related prudential rules.

Response

Mortgage lending is not currently restricted to credit institutions in the Irish market but it is obviously important to ensure that at a minimum there is a strong level of consumer protection including perhaps an appropriate prudential framework for all customers of mortgage providers.

Freedom of services provisions applying to entities other than credit institutions is a separate issue which requires further examination.