



Fédération Bancaire Européenne
European Banking Federation

FBE OBSERVATIONS
ON
THE GREEN PAPER ON MORTGAGE CREDIT IN THE EU

*Set up in 1960, the **European Banking Federation (FBE)** is the voice of the European banking sector. It represents the interests of over 4500 European banks, large and small, from 27 national Banking Associations, with assets of more than EUR 20 000 billion and over 2.3 million employees.*

The present paper aims to provide FBE's contribution to the public consultation that the European Commission has organised on the Green Paper on Mortgage Credit in the EU¹.

FBE has also contributed to the joint commentary presented by the European Banking Industry Committee (EBIC) on the same matter. The present paper should accordingly be read as complementing the EBIC's contribution.

¹ COM(2005) 327 of 19.07.05.

Introduction

FBE welcomes the approach adopted by the EU Commission in tackling the issue of integration in the mortgage credit sector in accordance with the “better regulation principles” recently adopted². In particular, FBE appreciates the commitment of EU Commissioner McCreevy to submit any further – not necessarily regulatory - initiative that might be envisaged following the outcome of the public consultation, to a thorough impact assessment before taking any decision on this matter.

I. PRELIMINARY REMARKS

Definition of mortgage credit

As a preliminary, general comment on the definition of the mortgage credit, we wish to stress the need to acknowledge and take into account, at EU level, the existence in the European Member States of two different criteria for identifying mortgage credits and credits for private consumption.

One criterion of distinction is the kind of guarantee securing the credit: a credit will be a mortgage credit or a consumer credit according to, respectively, the presence or absence of a real estate as the security of the credit. Another criterion of distinction is the nature of the purpose underlying the credit: the latter will be a home loan or a consumer credit according to the aim to be achieved by the borrower, respectively to buy/build/renovate a real estate or not.

Since in our view, any approach that would privilege one criterion over the other would not serve the purpose of achieving higher integration, we urge the Commission, when analysing the outcome of the public consultation and assessing the need of any action to be undertaken at EU level, to encompass both notions of mortgage credits, as appropriately done by London Economics in its Study³, in order to reflect the current structure of the market.

With regard to specific new products like Equity Release Loans (ERLs), we recommend the Commission to adopt the largest approach possible and to consider them amongst mortgage credits, without entering into a debate over what would be the best choice between one criterion and another. Indeed, in few Member States consumer credit rules already apply also to mortgage credits, so that a distinction would not be felt indispensable. On the other hand, in the majority of the EU Member States the link with the real estate originating the equity would justify the inclusion of ERLs into the scope of mortgage credit rules rather than into the regulation of consumer credit.

Definition of cross-border lending

In Annex I to the Green Paper, the EU Commission has also inserted a definition of what, in its view, cross-border lending is: *there is cross-border lending whenever a service crosses a border, be it through free provision of services, through an establishment (branch or subsidiary) or via an agent*. Given the importance of this issue for the industry and the prominent position it was granted in the Forum Group Report – as the very first Recommendation -, we believe it should be dealt with as the first step before going any

² COM(2005) 97, 16.03.05.

³ “The Costs and Benefits of Integration of EU Mortgage Markets”, Report for European Commission, DG-Internal Market, London Economics, London, 5 August 2005.

further in the analysis of the mortgage credit sector in the EU.

We strongly believe that this definition should also include mergers and acquisitions as a way to perform cross-border lending, insofar as the latter is considered a means – amongst others – to favour markets' integration. We would also suggest that the Commission does not exclude from this definition those cases – although limited – where borrowers may cross borders to look for mortgage credit offers, should it be by reason of location (consumers living in border areas) or of an interest to invest in foreign countries (e.g. holidays' real estates).

From another perspective, while we acknowledge that at present it is not common practice to conclude any mortgage credit contract by using the internet, we would suggest the Commission to look at this means as a powerful tool for advertisement and marketing that lenders will tend to use increasingly in the future. The potential development of cross-border marketing of mortgage credit products through the internet should not be prejudged by the attitude of regulators at EU or national level.

Margin for further integration of mortgage credit markets in the EU

We deem that national mortgage credit markets in the EU have already achieved, at domestic level, a substantial degree of integration and efficiency where competition is fierce and contributes to the provision of better prices and conditions to consumers. On the contrary, from an EU perspective the level of integration does not seem sufficient.

In order to encourage lenders to offer their products in countries other than those where they are established, facilitating the setting up of their branches abroad seems to be the most realistic and rewarding approach. Indeed, this market appears being offer-led and the proximity factor plays an important role in building the lender/customer relationship.

Were a business case to be proven in terms of achievement of further integration, the obstacles that need to be addressed first by the Commission are those which deter lenders from going cross-border. This is due to the fact that – as far as consumers are concerned – empirical evidence currently shows a fairly low cross-border demand in the area of residential mortgage credit. This low level of cross-border activity is, on the one hand, owed to infrastructural factors and the very nature of mortgage products which are characterised by their strong links to the property financed and the law of the country where the property is located. On the other hand, experience shows that when the lender crosses the border, consumers are interested in buying foreign mortgage products.

In this respect, any regulatory intervention should be aimed at facilitating building that relationship and undertaken only where and when it appears proportionate to the related costs for lenders, i.e. creates sufficient economies of scale for the lenders to sustain the economic effort on the medium/long term. We are of the opinion that full targeted harmonisation, i.e. full harmonisation of key elements regulating mortgage credit provision, should apply, so as to enhance both lenders' and consumers' confidence.

Among the obstacles which deter lenders from going cross-border we identify, in the order of priority: the lack of access to necessary information and registration (credit registers/databases, land and mortgage registers), the lack of legal certainty and security (forced sales procedures, valuation) and the hampered access to funding and secondary markets. Consumer protection issues are also to be addressed, especially those focusing on the Code of Conduct on Pre-contractual Information on Home Loans.

While identification of existing obstacles preventing consumers and lenders from taking full advantage of the single market is key, from the lenders' perspective it is equally, if not more important, to prove that the removal of these obstacles will have a direct effect in terms of net benefits. Against this background the findings in LE Report and their hypothetical package have to be assessed.

The comments below are presented following the order of priorities identified above, rather than the structure of the Green Paper.

II. OBSTACLES TO INTEGRATION

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.

Promoting equal access on a non-discriminatory basis to databases of each Member State is essential to guarantee a level playing field between national and foreign lenders and foster cross-border business. We encourage national authorities and the EU Commission to undertake more research on the modalities/arrangements for sharing data across Member States, in particular on authorisation to be sought from clients for use of data in accordance with the data protection and consumer credit legislation.

Land Registers

Before making further assessments, the Commission would welcome input on the issues of accurate reflection of charges in land register, the EULIS project and the related funding.

We agree that, in order to be binding for main and third parties, charges affecting real estates must be registered in an official Land Register and made accessible to those who may have an interest in that information. Transparency and legal certainty are indispensable to allow lenders to operate cross-border. Ensuring that national Land Registers make all relevant information available to all parties in a swift and non-discriminatory way is necessary to guarantee a level playing field among lenders.

This is particularly true with regard to the so called "hidden privileges" i.e. rights claimed over a real estate by a private or public creditor *after* the registration of the security into the Land Register. In some Member States such rights are ranked with a higher priority over other credits according to national law, without the need of any registration into the Land Register and regardless the time at which they were raised. Very often lenders may not be aware about the existence of hidden privileges, particularly when accessing a Land Register from abroad. These are actual obstacles to the cross-border activity.

We would recommend the existence of minimum requirements, especially with respect to creation, modification, extinction and priority ranking of rights in national Land Registers with an acceptable level of transparency. The procedures to be finally retained should be easily accessible, aiming at avoiding bureaucracy and time consuming administrative requirements to all parties involved. We are in favour of measures designed to ensure that registration and/or deletion of rights are made by order of receipt. Any other procedure would harm the reliability of the Registers and entail a lack of transparency with respect to their priority ranking.

With regard to the EULIS project, more coordination among Public Registers is to be welcome, although care should be paid to the level of additional costs drawn by the initiative. In accordance with the recommendations of the London Economics study, it is, in our view, necessary to promote and to support this project with financial input of the European Commission.

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.

Although lenders only turn to enforcement as a last resort, only after having adopted a wide range of measures aimed at helping the borrower experiencing financial difficulties before enforcing the surety, differences in forced sales procedures among Member States constitute a genuine obstacle to the development of cross-border distribution initiatives. Inefficient forced sales procedures can be the reason for not to start cross-border business at all.

A level playing field should be ensured among lenders on this aspect, i.e. the procedures for forced sales should be neutral in a bank’s decision making process of choosing a market to provide cross-border services. Therefore, binding measures regarding the timing to be respected in each Member State for the forced sale of an asset need to be implemented. The duration of a forced sale procedure should not exceed a term of two years as recommended in the Report of the Forum Group on Mortgage Credit (Forum Group Report).

The evaluation exercise combined with monitoring for the purpose of establishing an official scoreboard for every Member State are important measures to establish the cornerstones and guidelines of the local forced sale procedures. Improvements (wherever necessary) and eventually harmonisation (wherever possible) should result thereof.

Property Valuation

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

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

Although internationally recognised valuation standards to refer to might be useful for lenders acting cross-border (especially if they are prepared or recommended by an internationally recognised valuation body), we tend to believe that such standards would permit merely a rough or broad valuation of a property as all markets have peculiar and very specific characteristics that are difficult to be taken into account by international valuation standards and have at the same time a major impact on valuation and price.

The basis of valuation essentially covers valuation principles, definitions of values and issues related to the qualification of valuers⁴.

With regard to valuation methodology, although there is some convergence of valuation methods in Europe (for example income method applying to the valuation of commercial property and/or comparison method applying to the valuation of owner-occupied residential property), a methodology always reflects national, regional or even local market specificities and consequently varies throughout Europe. The application of a single European set of Standards to valuation methodology would therefore be inappropriate. Instead, minimum common standards coupled with the principle of mutual recognition should apply in accordance with Recommendation 25 of the Forum Group Report, in order to obtain property values which can be regarded as reflecting the local market conditions, i.e. complying with the local legal and tax systems and market participants' behaviour. A definition and a description of an internationally recognised valuation body would be necessary before adopting such a method.

Valuation criteria should in any event be related to the risk associated with the property as a sound and prudential credit management, since the purpose of assessing the value of the real estate is to protect the lender against a borrower's default. Accordingly, it should remain an option for the lender – and not an obligation – to obtain a valuation of the real estate. Furthermore, in order to avoid dramatic increase of the costs of valuation reports (since valuation could become very expensive when the report is very much detailed), valuers should focus on the relevant core risk criteria.

Applicable Law

In paragraph 32 the Green Paper is giving 3 possible solutions for the questions arising from the issue of Applicable Law with regard to mortgage credit contracts (specific regime for the law applicable to consumer mortgage credit contracts in future regulation; freedom of choice of law; exclusion of the application to a consumer mortgage credit contract of the consumer's mandatory protection rules).

We are of the opinion that aiming at achieving full targeted harmonisation, i.e. full harmonisation of key elements regulating the mortgage credit, as mentioned above, is a valuable approach allowing to override the *impasse* where a fully harmonised regime is not feasible at EU level. We deem it a better solution than any of the three options provided in the Green Paper to the extent of which the EU legislator will be able to reach a satisfactory level of harmonisation on core aspects of this specific sector.

On the other hand, we are aware of the ongoing discussion on the revision of the Rome I Convention. We would then urge the Commission to share information on these developments with the industry to allow us considering a contribution in this respect.

⁴ Indeed, as an example European Standards already exist for market value and mortgage lending value definitions as well as for other valuation principles (definition of valuer, content of valuation reports, independence of valuers, ethics etc.) and are provided by the European Group of Valuers' Association - TEGoVA. The same applies to educational requirements for valuers where the Euronorm 45013 provides a personal certification system as a European Standard. In addition to the latter, long established qualification

Euro-mortgage or Euro-hypothec

The Commission looks forward to receiving views on the feasibility and desirability of the Euro-mortgage.

As envisaged by the Forum Group, the Euro-Mortgage - or the Euro-hypothec - might be regarded as an example of 26th regime. Being designed as a collateral instrument identical in all Member States, it should not replace but rather complete existing national instruments, so that it would facilitate the cross-border transfer of the collateral, the coverage of multiple properties and would be secure in case of insolvency of the mortgage holder⁵.

However, in the absence of a clear definition of what a 26th regime would mean and how would it fit within national legal systems of Member States, a judgement of its feasibility and desirability is difficult to be given. We would advise the Commission to elaborate this project in a clearer way and to support an economic impact assessment thereof⁶.

It is important to stress, however, that a strict distinction has to be made between the Euro-hypothec as a collateral instrument and the issue of standardisation of mortgage contracts. We are in favour of further exploring the concept of a Euro-hypothec. On the other hand and in accordance with London Economics' findings, we strongly oppose any measures aimed at standardising mortgage contracts, which would inevitably lead to restriction of the range and number of mortgage products.

Tax

The Commission seeks information on tax obstacles to the cross-border provision of mortgages, similar to or other than those it has identified (such as the refusal of tax deduction for interest paid to foreign providers where interest paid to domestic providers would be tax deductible, or higher taxation of such interest) which are likely to infringe the freedoms provided for by EU law.

We welcome and support the Commission's intention to remove tax obstacles to cross border mortgage activities. This is a prerequisite for creating a level playing field. Additionally, the issue of governmentally applied fees is also considered an obstacle to the Internal Market and it should be investigated and addressed as well.

systems like the appointment by chambers of commerce or courts might be recognised as European Standards as well.

⁵ For the creation of an integrated capital market the Euro-hypothec could be an interesting tool. The Euro-hypothec is a non-accessory land charge – it may be charged on land situated in any Member State of the European Union - entitling the holder of the Euro-hypothec to the payment of a certain sum of money out of the property right. Regularly it is used in combination with a security agreement. The Euro-hypothec could be created to facilitate the transfer of mortgages: the different European mortgage law systems show some rigidities and inflexibilities in particular as regards cross border lending. Further, the existence of different mortgage systems in each of the EU Member States leads to difficulties in cross-border mortgage lending. Currently, cross-border lending is assumed to represent only 1% of the total amount of mortgage business. The creation of a Euro-hypothec valid in the different Member States as an additional tool could be appropriate to facilitate the development of a trans-national credit market.

The Euro-hypothec might support the development of new funding techniques by banks: it might facilitate credit institutions to transfer loans secured by Euro-hypothecs to other credit institutions. It could also be easier for banks to acquire other obligations secured by Euro-hypothecs, without the high costs in terms of time and expense, in order to improve their risk structure.

Funding of Mortgage Credit

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.

It is interested to assess to what extent a pan-European market in mortgage funding can be promoted by market-driven initiatives, e.g. on documentation standards and model definitions to be used in cross-border funding activities.

We welcome and support the Commission's intention to set up a working group in order to study the necessity and type of possible measures to be taken in this area. FBE is supportive of that initiative and would appreciate to provide bankers' expertise to contribute to its performance. We deem it fundamental also that the findings of such an ad hoc working group be made available before the Commission draws its conclusions and drafts the White Paper in the course of next year.

Risk diversification through the creation of efficient secondary mortgage markets, optimisation of funding conditions and better capital allocation (ex. through bankruptcy remoteness of covered bonds or special purpose vehicles, mortgage loans as assets which can be separated from all other assets of the credit institution etc.) do result in efficiency gains which could directly be transferred to consumers. Most of the initiatives in this sector are successfully market-driven and the input such a working group might give the Commission should allow the latter to better assess the need for any regulatory intervention. One of the areas for action where the intervention at EU level would be welcome can be identified in introducing common securitisation rules in order to facilitate mortgages' cross border sale and collateral.

In this respect, the Commission is interested in receiving views on whether mortgage lending should necessarily be an activity which is restricted to credit institutions, or whether and under which conditions such an 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 of all related prudential rules.

In order to ensure transparency and competitiveness of the mortgage loan market within the Member States, it is of utmost importance that any players in the market may rely on the principle of non-discrimination, i.e. to apply the same rules to players undertaking the same business under the same conditions.

We are strongly opposed to mortgage originators which would be exempt from all or a part of banking supervisory regulation or which would not be subject to the supervision of financial services authorities. Banking regulation does ensure high consumer protection standards. The admission of mortgage originators as non credit institutions would also lead to competitive distortions to the detriment of existing mortgage providers. In addition, it has

⁶ In addition, we wish to draw the Commission's attention on a recent publication made by a study group, 'Basic Guidelines for a 'Euro-hypothec' outlining the business cases which would benefit from this concept (edited by Polish Mortgage Credit Foundation, Warsaw May 2005).

to be noted that issues of capital requirements (cfr. Basel II for banks or Solvency II for insurance companies) have to be considered as well with respect to non deposit taking lenders.

III. CONSUMER PROTECTION ISSUES

Information provision

Should the Code of Conduct on Pre-contractual information on Home Loans be replaced by binding legislation or remain voluntary?

The Code of Conduct on Pre-contractual information on Home Loans ('The Code of Conduct') represents the common ground agreed between the industry and the consumers following a considerable investment of resources made by the industry. As an instrument of self-regulation, it has already provided good results in many Member States and should be maintained as such, in order for it to release all its potential.

The Code of Conduct allows to react flexibly to national conditions and to reflect different European funding traditions by avoiding systemic distortions. This instrument of self-binding regulation also allows to adapt more quickly and efficiently to changing market conditions without having to undertake a long legislative procedure, which would be the case for binding legislation.

We would like to stress that uncertainty concerning the future of voluntary regulation would have a negative impact on those EU Member States – in particular the new ones – having already or willing to put efforts in implementing the Code in their markets and/or removing existing deficiencies. We expect the Commission to encourage national legislators in those countries which have rules in force conflicting with the Code of Conduct, to bring them as much as possible in line with the latter as endorsed through the Commission's Recommendation of 1 March 2001, in order to ensure a level playing field to lenders across borders.

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

The pre-contractual information contained in the ESIS is complete, sufficient and also well balanced in order to avoid information-overload. In the ESIS consumers can find all information relevant to the conclusion of the contract and are thus able to get a complete picture about the credit and the related costs. The Commission should encourage the implementation of the Code of Conduct, since this should allow the already standardised ESIS model to fully serve as a means to provide such information.

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?

As clearly shown in the 2nd Progress Report on the Implementation of the Code of Conduct on Home Loans⁷, it is nearly impossible to identify one sole specific stage at which the ESIS should be handed over to the consumer in each and all Member States. This is due,

⁷ See p. 11 and 35-38.

among other factors, to differences in products' pricing (whether based on risk or portfolio) and in distribution channels.

Accordingly, a unique criterion should not be imposed to lenders. The moment at which the information is to be provided should not be imposed univocally, but a criterion of efficiency should be retained, i.e. flexibility should be allowed in the way the ESIS is provided by lenders in Member States, as long as there is still time for consumers to shop around.

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?

Although the development of the intermediaries' distribution channel may be different from one country to another, an equal treatment should be ensured to national and foreign players undertaking business in one Member State. This very much depends on what notion of "broker" is considered⁸. For a third party to be submitted to the same information regime as the one mandatory for the lender, that third party must at least have a role to play in providing information to the borrower.

Accordingly, with the exception of those who could be defined as "*introducers*", whose role is merely to identify potential clients for a lender and put them in contact with the latter without intervening at all within the negotiations of any mortgage credit contract, an information provision regime should not only apply to lenders, but also to third parties which are part of the credit mediation.

It must be noted, however, that those intermediaries who work with lenders applying the Code of Conduct, in most cases already comply with the Code by handing out to the borrower the information provided by the lender with the ESIS.

Advice Provision and Credit Intermediation

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

The provision of advice should not be made compulsory, as this would not satisfy the different consumers' profiles and needs. As it is correctly stated in the Green Paper, different categories of consumers need different kinds of information and have different relations to their providers. Therefore, only an optional provision of advice can assure that the consumer will not be restricted in his options and that the credit institution is able to build up a relationship with its customer according to the individual needs of the latter.

While it is coherent with the Code of Conduct that borrowers be provided with clear, objective and comprehensive information and explanation over the features of the product offered so that they can take well informed decisions on their own, we see no reason for introducing any compulsory advice. This would actually lead to unbalanced liability of the

⁸ As a way of example, the Financial Services Authority (FSA) in the UK identified no less than four different activities composing what is meant by "mortgage mediation activity"; each of them can be run by four different third parties within the negotiation and implementation of a mortgage credit contract. Those activities are namely:

- (a) arranging i.e. bringing about regulated mortgage contracts;
- (b) making arrangements with a view to regulated mortgage contracts;
- (c) advising on regulated mortgage contracts;
- (d) agreeing to carry one or more of the activities under (a) to (c).

lender vis-à-vis the borrower, without any real benefit for the latter. The provision of advice pertaining to customer care rather than to information provision and thus being a service *per se*, it should be left to the choice of the parties and submitted to competition. The borrower should remain free to ask for it if he/she so wishes; similarly, the lender should not be obliged to provide such a service if it does not intend to offer it.

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, advanced disclosure of fees, of the adviser's role and recording on durable medium)?

By definition, the 'advice' provided by the lender or the intermediary to the borrower is a tailor-made, personalised service which cannot be standardised. The introduction of standards for the advice would not correspond to the customer's individual situation. Apart from potential legal risks, which the Commission rightfully refers to, personalised customer advice needs to correspond to the customer's individual situation, income, financial circumstances and social environment. Only an individual and personalised advice that can be handled flexibly and is not submitted to further conditions can serve this purpose.

Early Repayment

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? If yes, under which conditions? Should this right be subject to compensation in the form of fees?

In order to respect the different funding systems and to maintain available the widest range of products in each Member State, the early repayment should not be imposed by the law as a right but left to the choice of both parties. The contractual nature of the early repayment option should be fully harmonised, i.e. valid in each and all Member States.

In those countries where long term fixed-rate loans are funded through the capital market and to which the matching principle applies⁹, the introduction by the law of a right for the borrower to reimburse a loan in advance would have the effect of banishing from the market those particular national products or funding techniques. From a competitive perspective, such an effect would damage products' variety and availability which are recognised to be the main driving force for economic growth of integrated markets.

By leaving the early repayment within the sphere of the parties' choice, all the options remain available to them at the moment they negotiate the contract. Should the borrower wish to secure lowest rate levels and be protected against the risk of rising interest rates for a long term, he may agree to limit his possibility of an early repayment to cases of legitimate interest (i.e. if the real estate is sold, if a mortgage is taken over it for another

⁹ This is the case in particular in Germany. The matching principle for interest rates prescribes that the total amount of outstanding Pfandbriefe has to be covered by mortgages having at least the same interest income at any time. If, due to important repayment volumes and debt rescheduling, new credit contracts can only be signed at much lower conditions (being inferior to the interest rates of the interest coupon of older Pfandbriefe), the matching principle would be violated.

The introduction of a long term fixed rate mortgage credit which can be repaid at any time would not be compatible with the requirements of the matching principle, even if the prepayment indemnity was compensated by the bank via early repayment fees. If an important quantity of loans were repaid early, the requirements related to the matching principle of interest rates and net present value cover for the protection of covered bond creditors might not be met.

loan or in case of death of the borrower)¹⁰, the enumeration of which should be fully harmonised across the EU.

Generally, borrowers have many different possibilities to arrange their financial needs in a tailor-made way, e.g. through a combination of long fixed rate periods with shorter periods, according to their personal situation. In addition to this, credit institutions also offer special redemption agreements. The borrower does also have the possibility to take out a mortgage loan at variable conditions. These loans can be repaid at any time. Though in this case, the borrower has to take the risk of rising interest rates, depending on the trends of the capital market.

It must remain on the remit of the borrower to choose the most suitable product for his particular situation, based on a proper information disclosure. In order to guarantee a level playing field for lenders across borders, in those countries where such an option is already allowed by the law to the borrower as a proper right, the borrower should be allowed to waive it.

Should an early repayment option be included in a mortgage credit contract, such an option has to be linked to terms which ensure that the bank does not pay for the damages caused by the early repayment. Full targeted harmonisation, i.e. full harmonisation of key elements should be applied in this case, since early repayment is one of the key aspects of mortgage credit that asks for comparability and fairness. The harmonisation should determine fair indemnities sufficiently differentiated to take into account differences in national legal systems, of refinancing conditions, type of rate (fixed, variable, semi-variable), etc. The industry should be consulted when selecting the criteria to be adopted to define what a “fair” indemnity is.

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?

¹⁰ The best market prices for borrowers are ensured by the funding of non-callable bonds, like Pfandbriefe, where the price is only slightly higher than the one of government-bonds. This protection mechanism against rising interest rates comes to a price which the borrower would have to pay as an **option premium** for the possibility of early repayment without any further restrictions. The value of this option differs according to the remaining credit term, the agreed interest rate, the volatility of interest rates and certain characteristics of termination.

This pricing mechanism can be found also in the US or in Denmark, where covered securities (Mortgage Backed Securities – MBS - in the US or Realkreditobligationer in Denmark) are callable. This means that the prepayment risk for mortgage credits is transferred via mortgage bonds to investors and is priced as extra charge within the interest rate. In the US, typical option-costs covering the risk of early repayment for liquid MBS ranged in the middle of the 1990’s between 70 to 100 basis points compared to US government-bonds with the same maturity. In Denmark, option costs were set at 30 to 40 basis points at the beginning of the 1990’s and have increased since. From 1995 to 2004, additional charges on interest rates for Danish callable bonds ranged from 100 to 255 basis points (compared to the corresponding State benchmark), whereas in the same period the German Pfandbriefe government spreads of the same maturity only varied between single-digit and low double-digit basis points to a maximum of 70 basis points (during the Asian crisis).

Respective studies confirm that in all European Countries, where prepayment fees are highly limited (for instance the Netherlands, Italy, Belgium, France, Spain), the option-premiums are set at 20 to 40 basis points (see A. Dübel, *Fixed Rate Mortgages and Mortgage Prepayments in Europe, an Economic Analysis*, Editions vdp 2005). This shows that in all countries, where prepayment of fixed-rate mortgage credits are not submitted to any or only few restrictions and therefore cause re-investment losses for lenders, borrowers have to pay high option-prices for the potential exercise of prepayment options. This makes it evident that option premiums for early repayment is one of the most expensive elements of credit costs, which will not considerably decrease in the near future.

In a well developed market, different products with fixed or variable interest rates and different prepayment schemes should be competing to the benefit of consumers. As mentioned above, full targeted harmonisation, i.e. full harmonisation of key elements should be applied in this case. The calculation method for the indemnity due in case of early repayment should be included in the mortgage credit contract. Legally enforceable caps on early repayment fees constitute barriers to market entry and hamper the development of certain products. They also lead to the restriction of access to credit for certain consumers¹¹.

In particular for fixed-term mortgages, legally enforceable caps on early repayment fees would oblige the bank to mutualise possible damages, i.e. to charge the costs to all mortgage borrowers by increasing interest rates according to the damages expected, regardless whether a borrower opts for an early repayment or not. This would lead to an inefficient system of cross-subsidising, where those clients not using the early repayment option would have to subsidise those who would use it.

Criteria to be taken into account when determining the early repayment fees should include:

- as for actuarial calculation of the funding loss suffered by the lender,

- the type – fixed or variable – of rate;
- the degree - high or low - of variability;
- the remaining term before the expiration of the period, knowing that the loss will vary depending on the more or less long period still to be covered;
- the actual evolution of the interest rates on the market, to detect purely speculative transactions;

- as for the compensation of other costs faced by the lender,

- the administrative/operational costs involved in handling the early repayment.

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

Consumer information is a key element of a fully integrated market which is characterised by adequate product variety. It is therefore necessary to adequately describe to the customer the products' features and to inform him about conditions of any early repayment option when concluding the contract.

It is however not always possible to indicate the precise amount of early repayment fees before the conclusion of the contract, as the amount of the indemnity depends on factors which are not known at that time.

¹¹ Models of limited compensations can lead to alterations in market shares. Loans with limited prepayment compensation schemes primarily provoke an alteration to the detriment of fixed term mortgages. In Spain and Portugal, for instance, only mortgage credits with variable interest rates are available, since limitations on early repayment fees have driven fixed term loans completely out of the market. If offers of fixed term loans were completely missing, this could lead to problems for borrowers to fulfil their payment obligations in case of rising interest rates, thus increasing consumers' indebtedness. From a macro-economic perspective, it is neither

Annual Percentage Rate

What is the purpose of an APR: information? Comparison? Both?

Should there be an EU standard covering both the calculation method and the costs elements? If so, what kind of cost elements should such an EU standard include?

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.

As in many Member States the calculation method for the APRC for consumer credits also applies to mortgage credits, the calculation of the APRC for mortgage credits is de facto already based on a standardised common methodology following the harmonisation made by the Consumer Credit Directive as amended in 1998. Nonetheless, should a specific “mortgage APRC” be needed, different from the one already provided within the current - and forthcoming - directive on credit to consumers (which remains to be assessed), the APRC should be subject to full targeted harmonisation i.e. full harmonisation of key elements (method of, and basis for calculation) so that both comparison and information are allowed.

In particular, to guarantee the highest level possible of comparability across borders, any definition and calculation should be narrow and restricted to costs levied by the lender for his own benefit (e.g. net interests, administrative costs, lender’s commissions). Charges that are levied by third parties and not paid to the lender (e.g. notary and mortgage registration fees, Land Register fees, additional insurance fees, etc.) should neither be included within the definition nor in the calculation basis of the APRC, since they are not under the responsibility of the lender and might vary across Member States so that like-for-like comparison would not be achievable. Lenders should not be requested an exhaustive and binding list of such additional costs, since their imputation and levels may be unknown to lenders, especially in a cross-border context.

Usury Rules and Interest Rate Variation

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

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

Usury rules adopted, or in their process to be adopted by several Member States have a specific purpose of public order, i.e. to protect citizens against criminal behaviours. Usury rules should thus be regarded within a broader context than the mortgage credit sector and not dealt with at EU level by a specific initiative limited to mortgage credit.

It should however be avoided that usury rules are misused by Member States as a form of price control over the mortgage market players.

Do such restrictions hinder market integration? What impact can they have on the development of particular products such as equity release products?

A usury rate should be identifiable as such following a criterion of public order. As a matter of example, it must be noted that for the majority of Member States an interest rate is considered usury when there is a clear disproportion between the market rate and the interest applied to the loan¹².

On the other hand, legally enforceable caps on interest rates and interest rate's variability¹³ constitute barriers to market entry and hamper the development of certain products. They also lead to the restriction of access to credit for certain consumers¹⁴. Lenders should be free to modulate the offer without legally imposed caps.

Credit Contract

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

The issue of the introduction of a so-called 26th regime is currently widely discussed at European and national level. The usefulness of this concept for the integration of mortgage markets has to be further examined, in particular because at present there is not yet a clear definition of what should be understood as a "26th regime".

With regard to the mortgage *contract*, we consider contractual standardisation as harmful for the efficiency of the mortgage market - at European as at national level - since it would hamper innovation. On the other hand, we would be interested in knowing more on the definition of a Euro-hypothec as a different example of 26th regime applied to the mortgage collateral.

We are in favour of further exploration of the Euro-hypothec concept, in particular in having a feasibility/impact assessment of advantages and disadvantages of such a new instrument, once in place. Nevertheless, at the present stage the focus of the Commission should be put on the removal of other obstacles rather than on the creation by directive/regulation of a new instrument.

Enforcement & Redress

Should the Commission consider imposing on Member States an obligation to ensure the existence of such alternative means of redress in the mortgage credit area?

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

As first step, a clarification on what kind of redress is meant (judicial or extra-judicial) would be needed. We see more a lack of knowledge by the public of available alternative

¹² As a matter of example, in Germany an interest rate is considered usury when it exceeds the market rate by 100% at least; "In Italy, an interest rate is considered usury where it exceeds 50% of the Global Effective Rate, i.e. the average rate surveyed by decree from time to time by the Ministry of the Economy and Finance for different sets of operations". In France mortgage credits at a fixed APR of 6.03% and variable APR of 5.52% respectively are considered "excessively high" interest rates and are thus banned as "usury".

¹³ In Belgium legally enforceable caps on rate variation also constitute a barrier, particularly when they are accompanied by additional terms as e.g. the rate cannot vary higher than the contractually provided floor, which may represent a barrier in case of (very) low market rates.

¹⁴ In France, due to the very low threshold that is set for defining usury rates, it is de facto impossible for lenders to offer sub-primes i.e. loans to borrowers whose credit score is lower than required for mainstream lending.

schemes for redress, rather than a lack of credibility thereof. A full targeted harmonisation approach should apply, i.e. not a minimum equivalent protection at the highest current level, which would be contrary to the single market development.

Following the recommendations of the London Economics', the extension of the already existing FIN-NET network could be useful for cross-border mortgage credits, based on a closer cooperation among national bodies in order to increase transparency and ease of access at European level.

Conclusion

In the light of the "better regulation principles" FBE appreciated the approach of the Green Paper as looking for evidence for a business case for any regulatory intervention at EU level. We believe that there is room for further integration of mortgage markets and benefits to be derived from it. What is however not clear, is how much room there is and whether or not there is a business case for Commission action.

On the key question to be addressed by this Position Paper – namely, whether the expected benefits from a Commission's action would outweigh the anticipated costs of the regulation – FBE believes that this point remains to be proven. Indeed, the London Economics' Report on the Costs and Benefits of Integration of European Mortgage Markets does not seem to provide sufficient evidence in itself to justify concrete policy measures.

Were a business case to be proven, it is clear from what has been said in this Position Paper that the obstacles that need to be addressed first by the Commission are those which deter lenders from going cross-border. Indeed, it was a necessary and useful exercise carried out by the Forum Group on Mortgage Credit to identify as a first step, existing obstacles which prevent consumers and lenders from taking full advantage of the single market.

However, from a lender perspective, it is even more important to first prove that the removal of the obstacles identified would bring the purported benefits. This has not been achieved yet. Furthermore, the different policy measures that could be adopted to achieve further integration must be evaluated individually. A Commission's action would be justified only if an impact assessment carried out with regard to each one of these measures individually gave evidence that the expected benefits would outweigh the anticipated costs.

Finally, FBE would like to confirm its willing to put its expertise and contribution at the disposal of the Commission and to contribute to forthcoming discussions with the Commission and other stakeholders on this matter.