

Opinion
of the European Union of Developers and House Builders– UEPC
on the EU Commission Green Paper on „Mortgage credit in the EU“

The UEPC represents more than 30,000 developing and house building companies, affiliated with its 13 member federations. Directly or indirectly the activities of these developers and house builders represent 10% of gross national product and employment in Europe. Together, they annually build and develop several millions m² of offices and shopping centres as well as more than 1.000,000 new homes.

Developers, members of the national federations affiliated to UEPC build and sell houses and apartments to consumers who in 95% of the cases finance their purchase with a mortgage loan. The UEPC is interested in a mortgage market that functions properly and its opinion is impartial and unbiased as its members are not directly involved in the mortgage loan contracts.

The UEPC subscribes to the EU Commission's approach towards removing the problems of mortgage loans from the EU's draft new consumer credit directive and its putting the question whether the Commission should be active in the EU markets for mortgage loans forward for broad discussion amongst the interested groups in a Green Paper on the basis of the recommendations. UEPC would take this opportunity to comment on the considerations of the EU Commission contained in the Green Paper on mortgage loans of 19.07.2005. The opinion is limited to points of obvious importance to the European property industry.

The UEPC generally welcomes the EU Commission's efforts to ease cross-border transactions in mortgage loans and the transfer of real security. In particular, the EU Commission's efforts to dismantle tax barriers to the cross-border granting of mortgage loans are expressly supported. A performing, competitive market for mortgage loans as required for integration could contribute consistently to the growth of the European property industry.

However, the basis for harmonising the mortgage loan markets should in first instance be freedom of competition within the European Union. The introduction of EU-wide standardised pre-contractual user information and advice on obtaining credit as emphatically provided in the Green Paper would have just as substantial an effect on the development of credit conditions as harmonised arrangements for the premature cancellation of mortgage loans and restrictions in penalties for premature repayments, and would in all probability result in increasing regulation with an increase in costs as the possible result, which would ultimately be passed on to the customers requiring finance.

The maximum harmonisation of mortgage credit markets in the EU on consumer policy grounds, recognisable in the Green Paper, has met with essential objection and still requires discussing in depth. The risk of departing from the principle of the consumer's own responsibility should not be overlooked. The personally independent decision to what extent he requires advice and what financial burden is acceptable to him should be left to the latter.

With a view to strengthening consumer protection, it seems questionable whether room for individual government regulations should usefully be excluded from all regulated areas of the mortgage loan markets.

I. Consumer protection

• Consumer information

In an integrated internal market where the consumer can also conclude cross-border mortgage loans, consumer information has an important function. Indissolubly connected with this understanding of the internal market is a well-informed, intelligent consumer, who can critically assess mortgages offered and contracts in full knowledge of all product-specific features. The information should be complete and transparent, to ensure comparability between what is offered. The European credit industry has pursued this objective with its code of conduct for private mortgage loans. The pre-contractual information contained in the standardised notes (ESIS) is comprehensive, adequate and also balanced, in order to avoid an overload of detail. The customer can obtain all relevant information for the contract from the notes and is therefore able to form a complete picture regarding financing and the associated cost. From the property industry's aspect, there is no reason for departing from the voluntary code that the credit industry has successfully implemented in recent years at great expense. We therefore emphatically advocate adhering to the code of conduct and maintaining its voluntary character. Only with the code is it possible to respond flexibly to national circumstances and portray the multiplicity of European financing traditions while avoiding systematic encroachment. The self-regulatory instrument can also be adapted faster and more efficiently to changed market conditions without having to pass through a complete legislative process – as would be the case with binding regulations.

The particulars (offer procedure, application procedure, time for reflection, cancellation rights, etc) differ widely within the EU on traditional grounds. The customer's specific requirements must also be taken into account. It therefore quite frequently happens that the customer insists on rapid conclusion of the loan agreement because he has already signed the purchase contract for the property. Nonetheless, it has been proved that the present handing-over practice under the ESIS notes allows consumers in all member states an opportunity to obtain alternative offers from other credit institutions before completion. Consequently, in the UEPC's view, there is no reason for changing the existing practice.

• Advice and granting of loans

The introduction of a binding duty to provide advice at European level would in our view not do justice to the varied consumer profiles and needs. Precisely the quality of advice represents a differentiating feature in competition. A binding advice requirement would presuppose that the content of the advice could be precisely and conclusively listed. However, this is hardly possible in practice since – as the EU Commission correctly states in the Green Paper – account must be taken of consumers' differing needs for information. Consequently, only non-binding advice will ensure that the consumer's freedom of choice is not restricted and a client relationship aligned to his individual needs can arise. A binding duty to give advice would in any event jeopardise direct distribution of mortgage loans and thereby deprive a modern, flexible distribution outlet of the growth potential it is entitled to expect in the future.

Laying down standards for advice would, moreover, give rise to imponderable legal risks. Information must be aligned on advice tailored to the borrower concerned, to his individual situation, his income and assets, and his social background.

• Premature repayment

Substantial reservations exist against a statutory arrangement for premature repayment of mortgage loans. Any such far-reaching provision would undoubtedly reflect on credit conditions and in all probability mean an increase in costs which ultimately would be passed on to customers requiring finance. This could complicate, if not completely prevent, the opportunities for property financing

precisely for the lower-income groups. Such a scheme would prove particularly disadvantageous to the consumer planning for the long term, desiring certainty and calculability.

• **Waiver of premature repayment**

The EU Commission also recognises that fixed-interest mortgage loans help to protect consumers. Within a balanced sharing of interest, borrowers ensure low interest rates for the duration of the fixed interest period, are protected against interest rate rises, and undertake, in exchange, to repay the loan prematurely during the fixed interest period only for good reason. It would therefore seem logical, simply on applying the general contractual principle of „pacta sunt servanda“, for the borrower to be able to dispense with the possibility of premature repayment should he so desire. This in no way gives rise to a situation that would be disadvantageous to the borrower or tie him unreasonably long to the bank. Fixed interest loans offer borrowers a high degree of flexibility. The customer opts for a locked-in interest rate against the background of his individual needs and after considering the further development of the market rate, at the end of which he can repay the mortgage loan without paying the full amount of the premature repayment fee. This offers a multiplicity of potential structures, such as combining lengthy fixed interest intervals with shorter periods, depending on his personal circumstances. In addition, credit institutions also offer special repayment agreements. Finally, the borrower is also able to take up a mortgage loan on variable terms. This can be cancelled at any time without paying a premature cancellation fee. However, the borrower then bears the risk of interest rate increases, depending on how the capital market develops.

• **Premature repayment fee**

A premature repayment arrangement must apply to premature repayment of a fixed interest loan before the fixed-interest period has expired, to ensure that the lender need not bear the loss resulting from premature repayment. Calculation methods exist for this in Germany, confirmed by the senior courts, that allow the loss sustained by the lender to be objectively and precisely calculated. A situation without compensation or with only a restricted model for compensation would in turn compel the lender to include an option price to the extent indicated above as an addition to his margin.

In particular, upper limits or lump sum payments lying below the lender's actual interest in performance must be avoided. Restricted penalty models would then be to the detriment of the lender. The lender would in turn have to generalise potential losses, i.e. transfer them to all mortgage borrowers, by increasing the conditions in line with the anticipated loss and do so whether or not the customer exercises the repayment option. This would give rise to an inefficient cross-subsidising of users of the repayment option by the other customers. To avoid this, the borrower should also be able to opt for a fixed-interest variant.

• **Consumer information**

In the UEPC's view, no particular degree of approximation or harmonisation is necessary either for premature repayment or for the premature repayment fee in order to make further progress on integrating the European mortgage markets. In a duly developed internal market, various products must in each case be able to compete with each other to the consumer's advantage with fixed or variable interest rates, in each case with different premature payments systems. In a fully integrated market, characterised accordingly with a great multiplicity of products, information for the consumer plays an important role. The customer must therefore be familiarised with the project profile of the credit type concerned when credit is offered and on concluding the contract, and be comprehensively informed on the means for premature cancellation of the finance. It is of course not possible to advise the borrower in advance when concluding the contract of any premature repayment fee payable in the form of a specific amount since the amount of the fee depends on factors which are not yet known at that point. The ESIS notes include a mention of the legal position concerning premature repayment. It remains to be seen whether it would be of added value for the consumer already to be advised of the possible amount of a later fee by typical, standardised arithmetical examples.

• **Effective annual interest rate**

The method of calculating the effective annual interest rate for consumer loans was largely harmonised by the re-casting of the Consumer Credit Directive in 1998. Initially, full harmonisation should follow, especially in the newly added member states, before wide-ranging efforts are made to harmonise the calculation of the effective rate for mortgage loans.

Mortgage loans should in no way be subjected to a special methodical approach to calculating the effective interest rate since this would result in barely soluble problems of delimitation and unjustified expense for the credit industry, which would ultimately be passed on to the customer seeking finance. The question therefore still arises only of uniformity in calculating the effective interest rate, which can be answered by the purpose of the rate concerned. True, the effective interest rate serves both for information and for comparison but in the European context comparisons are clearly the most important. Consumers should be able to compare the prices of loans offered in the various countries with each other. It would therefore be advisable to standardise the cost factors for the effective interest rate for mortgage loans EU-wide. However, the comparing function requires the cost factors underlying calculation of the effective interest rate to be clearly defined, since comparability could otherwise no longer be assured due to the sharp differences in cost profiles across the EU. The calculation should therefore include only the costs occasioned by the lender or those that can be influenced by him and the amount of which is already fixed at the time the contract is concluded. The cost to be included in the effective annual interest rate is in Germany regulated by the well tried provisions of the Pricing Regulations. For annuity-based mortgage loans, for example, this would include, apart from the interest and redemption payments, the processing charges, valuer's costs or an obligatory residual debt insurance. The costs that should not be included in calculating the effective interest rate are notarial and land registry charges, brokerage and the premiums for a life assurance that serves subsequent repayment of the loan. We do not consider separate listing of these third party expenses to be possible, since the credit institution cannot calculate them. These costs should only be mentioned as to type and not as to amount.

• **Extortion and variable interest rates**

Extortionate interest rates are legally prohibited in Germany. According to precedent, extortionate interest rates arise if they lie at least 100 % above the interest bands customary in the market for loans of this kind. We take the view that regulations concerning extortionate rates are not necessary at European level. There are no evident negative effects in this connection on market integration nor are they to be feared for the future. In no way would a specific initiative limited to more mortgage loans be advisable. No restrictions can be advocated regarding interest rate fluctuation bands or cumulative interest rates. They would, for one thing, militate against the concept of a fully integrated internal market, featuring the greatest possible product variety and availability.

• **Credit loan agreement**

Standardisation of mortgage loan agreements would prove competitively unfavourable to a customer requiring finance. Competition is actually supported by the multiplicity of terms and conditions of contract. The directive concerning protection against abusive clauses in contracts offers adequate legal protection and the necessary check on transparency against an abuse of the contractual clauses.

Against the background of the market-related approach already outlined, the UEPC would not support standardisation of mortgage loan contracts.

• Implementation and legal remedies

A cheap, effective ombudsman process has proved its worth in the mortgage loan area in several member states. It applies to all areas of business and would consequently also apply to cross-border mortgage loans. A positive example of the strengthening of consumer confidence in this connection is also the introduction of FIN-NET, that offers consumers unbureaucratic, rapid assistance in cross-border disputes.

II. Legal questions

• Applicable law

The UEPC recognises the advantages associated with retaining the general principles of private international law, as at present anchored in the Treaty of Rome. This applies especially to the principle of freedom of choice of law and the associated possibility for the lender to offer mortgage loan products developed for the home market abroad as well, as unchanged as possible – freedom of choice of law is a prerequisite for the multiplicity of sales opportunities in the EU. However, the principle of free choice of law also affects aspects of consumer protection law – the consumer is faced with differently oriented national consumer protection rules.

• Valuations

With regard to property valuation it has been found that the principles of valuation are not compatible in individual member states. Harmonisation of the principles of valuation is therefore urgently required. Evidence of this are the difficulties at present faced by foreign investors when valuing German property portfolios.

The bases of valuation in first instance include definitions of value, valuation yardsticks and the question of valuers' qualifications. The valuation of properties usually depends on ascertaining either the market value or the lending value. European standards are available for both definitions, worked out by the European umbrella association of property valuers' associations TEGoVA (The European Group of Valuers' Associations). For bases of valuation, the aim should therefore be to apply European standards. It would seem impossible to form a basis for a single European standard.

With regard to small loans for property in residential use, the need for a formal report by a qualified expert seems unnecessary up to a limit to be fixed. Here, as is already customary in several member states, resort should be possible to a simplified valuation, undertaken by adequately trained, qualified staff of the lending institution. Formal reports for small loans would entail substantial administrative cost which would be out of all proportion and ultimately borne by the borrower.

The position with valuation methods is different. True, certain similarities may be observed in the methodical approach in Europe, since leased property is valued in all countries by the productive value method and owner-occupied property by the comparative method or tangible value method.

However, there are differences in detail since valuation methods always also create specific market conditions. These market conditions differ through the variation in legal and tax systems or through variations in approach by market operators.

- **Enforced sale procedures**

The sustained value of property liens and the question how and when the security put up can be valued are decisive criteria in the lending process. Inefficient enforced sale procedures may be a reason for not proceeding at all with cross-border transactions. Since standardisation or approximation of national enforced sale procedures is hardly to be expected in the near future, it would be welcome if the EU Commission would as a first step provide all concerned with information on the cost and duration of compulsory enforcement procedures in all member states and keep it regularly updated. Here, too, however, costs and benefits must be carefully weighed up against each other. Any costs that might be charged in this connection may be imposed only on those who actually make use of this service.

- **Taxes**

The UEPC welcomes and supports the EU Commission's proposal to dismantle tax barriers to the cross-border granting of mortgage loans.

III. Mortgage security

- **Land registry**

Land registers or mortgage registers play an important part as centralised evidence of all procedures, charges etc relative to the land. These registers should therefore first of all provide exhaustive information on the charges on the land – to the effect that all existing rights and obligations must actually be entered up.

The EULIS project supported by the EU Commission has made an important contribution towards this. We feel it necessary for the Commission to develop this project further with appropriate financial support. It would not least be desirable, also to ease handling for the consumer, if the creation of property liens could be ensured through proper EDP solutions.

- **Euro mortgage**

The introduction of a not strictly accessory European property lien (Euro mortgage) would represent a major step forward in the efforts to make national mortgage loan markets more flexible. Borrowers would have improved opportunities to use the properties owned by them to generate loans. The easier transferability of property security would also have a key function in building up a liquid secondary market for mortgage loans or a certification market (MBS). We therefore support considerations in this connection. Initially, the economic advantages and disadvantages associated with a Euro mortgage should be assessed at national and international level (effects study). EU Commission support for such a study, possibly including external economic expert assistance, is advocated.

IV. Refinancing of mortgage loans

- **Restriction of mortgage lending to banks, insurance companies and building societies?**

To what extent there is a need for mortgage loans to be granted by others than credit institutions cannot be finally assessed at present. Having regard to the increased financing of property by private investment companies, the situation may change in the medium term.

Conclusion

In the UEPC's view, the greatest added value for consumers in an integrated mortgage loan market is the ability to obtain access to a large number of different alternative fundings. The multiplicity and availability of products are the two aspects with which the greatest economic benefits are associated. Transparency and consumer information play a central role in this approach since only a well informed consumer can benefit from the product variety in view. As a result, integration of mortgage markets will achieve the anticipated economic added value only if they are sustainably motivated by freedom of competition.

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