



## FLA RESPONSE TO EU COMMISSION GREEN PAPER “MORTGAGE CREDIT IN THE EU”

### 1. INTRODUCTION

The Finance & leasing Association (FLA) welcomes the opportunity to comment EU Commission Green Paper (GP) Mortgage Credit in the EU. The FLA is the main representative organisation for the UK consumer credit, motor finance and asset finance sectors, and the largest organisation of its type in Europe. Our members comprise banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms. The facilities they provide include secured and unsecured personal loans, credit cards, store cards, Hire purchase, conditional sale and leasing.

The UK consumer credit market is the largest in Europe, accounting for nearly one third of the total credit granted in the European Union.

FLA members provided £68.4 billion (€100.8 billion<sup>1</sup>) worth of new finance to the consumer sector in 2004.

### 2. OVERALL COMMENTS

#### 2.1 Application to Secured loans

FLA’s primary concern in relation to the Green Paper (GP) relates to secured loans or second charge mortgages. In the UK there is a well developed and competitive marketplace in the UK for non-purchase second mortgage market or “secured loans”. FLA members accounted for £4bn of secured loans in 2004.

The market for secured lending is distinct from the purchase mortgage market, it operates via differing delivery channels, and under a different regulatory regime.



<sup>1</sup> Based on a European Central Bank exchange rate for 2004 of £0.6787/€

The comments and proposals in the GP are however expressed to apply equally to mortgages to finance the purchase of real property over which the security is created and to second mortgages or secured loans to consumers for purposes unconnected with the purchase of the property. Our fundamental point is that given the differences between products there must be proper consideration of secured loans and the proposals should not be unthinkingly applied across the board.

Secured consumer loans are usually of significantly lower amounts and for shorter periods than mortgages, the purposes of such loans are varied but, essentially, the purposes cover the full spectrum of consumer borrowing needs. The ways in which secured loans are marketed and the circumstances surrounding the take up of such loans are also different. Secured loans also provide a much greater degree of flexibility for consumers and choice. They are used as a tool for consumers to manage their money, access affordable borrowing and offer flexibility.

The distinction between the two types of lending has been recognised in the UK. In consequence, there are separate regulatory regimes with separate regulators. The Financial Services Authority (FSA) regulates first-charge mortgages used for domestic land and house purchases. Consumer Credit Act regulation and the Office of Fair Trading (OFT) regulate second mortgages or secured consumer loans.

The removal of the CCA financial limit under provisions in the Consumer Credit Bill will, when those provisions take effect, bring most secured consumer loans within the scope of consumer credit regulation.

The GP, at paragraph (8) specifically recognises the potential range of loan agreements secured by mortgages but the GP does seek to question whether there should be different regimes for different characteristics of the loan. The focus of the GP is on the existence and the nature of the security and assumes that the measures suggested will be appropriate across the board.

Despite the difference in regulatory approach and consumer use of second charge loans the paper does not make any real distinctions between purchase mortgages and secured loans or carry out further analysis of the proposals in relation to secured loans. In our view, this is a major omission and we believe that further work should be carried out to analyse the appropriateness of the proposals in relation to second

charge loans. FLA are concerned to preserve the flexibility of the second charge mortgage market in the UK via appropriate regulation and consumer protection measures.

In our view, it is impossible to consider the areas of consultation, or move forward with the objectives of the GP without a more fundamental examination of the impact on secured lending and the applicable regulatory approaches within different jurisdictions.

## 2.2 Approach to Regulation

We support many of the comments made by the Council of Mortgage Lenders (CML) in their response about the general approach to regulation. The GP should be subject to the critical examination advocated by Commissioner McCreevy and intervention in the form of regulation should not be seen as inevitable. FLA believes regulation should only be introduced if a clear need has been established after a full cost benefit analysis has been carried out and all alternatives explored. This analysis must relate to all products and markets which will be affected. The cost-benefit analysis for mortgage as opposed to secured lending will be different. Secured lending should not simply be swept-up in a general regime for mortgage lending as a whole, proper analysis must be undertaken.

### **Integration and cross border lending**

We broadly support the comments made by the CML in their analysis of cross border lending. As indicated above, the question arises as to whether increased integration for secured consumer lending should be by reference to the existence and characteristics of the security. Again, the GP applies its analysis, research and proposals to purchase mortgages and we believe further analysis is required to consider the aim of integration for secured loans.

## 3. RESPONSE TO SPECIFIC POINTS

As above, FLA's principal concern relates to issues relevant to consumer lending rather than first mortgages. With regard to first mortgages, FLA supports generally the response submitted by the CML and the British Bankers Association (BBA).

FLA does have a number of specific points on the propositions in the GP and the response to the Forum Group Recommendations.

### **3.1 Consumer information**

The current position in the UK is that the pre-contractual information for first mortgages, which are predominantly purchase money mortgages, is within the FSA regulatory regime whereas all aspects of secured consumer lending are within the Consumer Credit Act regulatory regime. The latter is, of course, a regime which is applicable to all consumer credit (subject to current monetary limits) but with some additional provision specifically applicable to land mortgages. The point is to provide consumers with appropriate information which is consistent with the nature, purpose and characteristics of the borrowing they are entering into.

### **3.2 Early repayment**

FLA supports the objective to ensure that the method of determining early settlement terms is fair and equitable to both lenders and borrowers. A fair and equitable basis requires a lender to be compensated not only for the losses which it incurs as a result of early settlement but also for the set-up costs agreement. FLA believes that it is essential that lenders should have the right to recoup their real costs without the imposition of a cap, otherwise this will increase the costs of loans or lead to cross-subsidisation.

As the GP notes, the mechanism for early settlement varies considerably across member states. In the UK, secured loan borrowers have a statutory right to settle early their loans. The mechanism for settlement and the calculation of the settlement figure has recently been reviewed by the DTI to ensure that it is fair.

### **3.3 Duty to advise**

In the UK, the provision of advice for mortgage lending is optional and both mortgage lenders and secured lenders believe that their key duty is to provide information in a transparent and accurate way that will enable consumers to take responsibility for their decisions. Consumers take out secured consumer loans for a variety of purposes including debt consolidation, home improvements, to fund other large purchases or to support small businesses. A duty to advise would be inappropriate given the complexities associated with these purposes and the absence of any

requirement on the consumer to disclose information, which might have an impact on the advice given. There are also complexities associated with UK based schemes or initiatives such as the right to buy state-owned properties or legal aid or community aid funding which may result in a secured loan on the property.

It would be inappropriate and disproportionately costly for such duty to be imposed in the circumstances. If any regime resulting from the GP were to require compulsory advice for mortgages, then that would lead to a distortion of the market. Such requirement to give advice in respect of all mortgages, including secured consumer lending, would impose a burden on a lender simply because of the existence of the security, whereas a consumer loan for a similar purpose, generated through a similar marketing channel, would not impose this burden. There should be a level playing field according to the true nature of the loan agreement.

We think these concerns are best met by ensuring consumers are given open and transparent information to make informed buying decisions.

### **3.4 APR**

In the interests of lenders, consumers and regulatory authorities, it is self-evident that the composition and calculation of APRs should be the same across the board for all loans of all amounts and whether secured or unsecured, and whether purchase money mortgages or secured consumer loans.

### **3.5 Usury rules and interest rate variation**

The DTI commissioned a Policis to carry out research on the operation of rate capping in the US (where rate caps are set in some states but not in others), Germany and France. The report informed DTI policy not to introduce an interest rate cap in the UK due to the distorting effect it can have on the marketplace. The FLA supports this approach and believe that rate-capping in the UK would be a retrograde step and unduly restrictive on product innovation and the market generally.

### **3.6 Credit Contract**

Referring back to the earlier general comments, it is essential that secured consumer lending is considered fully. If not, there is the risk that any standardisation of contract

terms which may be devised for purchase money mortgages will be applied without proper thought to all consumer loan agreements, simply because they happen to be secured. Any regime for purchase money mortgages may be wholly or partly, inappropriate to consumer loans. Overall we would not support a standard contract as it may be unnecessarily restrictive and impractical.

### **3.7 Applicable law**

As the GP notes the determination of applicable law under the Rome Convention is under review. It would be very confusing for lenders and borrowers if secured consumer loans were subject to a different legal jurisdiction from unsecured consumer loans. The principles of the Rome Convention, if they continue to apply to unsecured consumer loans, should continue to apply to secured consumer loans. There is no conflict between this and paragraph (33) which, understandably, recommends that the law applicable to the collateral should remain that of the country in which the property is situated.

### **3.8 Client Credit Worthiness**

Full and accurate information can assist lenders to avoid extending credit to those already on the margins of their own particular affordability level. It will not prevent some unforeseen circumstance – such as unemployment – from causing financial difficulties, or prevent an individual, who is determined to over-commit him/herself, from doing so.

In the UK data is shared on a reciprocal basis which will allow new entrants to enter the market and access information about individuals in the UK. Credit reference agencies hold both publicly held information and shared data. Public data includes the register of voters, County Court Judgements, and bankruptcies. Shared data includes credit account information, credit 'searches', repossessions data, and fraud prevention information. The GP paper concentrates on the sharing of 'private' data.

Access to client databases is an important facility if lenders are to enter new markets on a fair and competitive basis within Europe. In order to ensure that the database is maintained and reliable data must be shared on a reciprocal basis and carry the necessary level of information to enable those accessing it to make proper assessments. It is important that the GP recognises the flexibility required to make

non-discriminatory access work effectively across 25 member states. The emphasis must be on reducing barriers to access, rather than on constructing restrictive regulatory structures for database operation.

Secured consumer lending should be regarded in the same way as unsecured lending for all purposes relating to the nature and characteristics of the loan and of the market in which it operates. Therefore, the question of reciprocity should be decided according to the principles adopted in respect of consumer lending generally, even if there was to be a departure from this for purchase money mortgages. Our position is, however, very firmly that there should be reciprocity in respect of all types of lending.

### **3.9 Euromortgage**

Again, the differences between purchase money mortgages and secured consumer lending need to be borne in mind. A “Euromortgage” model for purchase money mortgages will not necessarily be appropriate for secured consumer lending.

### **3.10 Collateral Issues – registration of charges**

The proposition contained in the third bullet point, Annex II, Paragraph 30 that registered charges on real property shall rank in order of priority disclosed in the Public Register does seem to be a sweeping generalisation. There needs to be a proper study as to what the objectives of such a regime should be, and what the results would be.

FLA, November 2005