

**CML comments on the London Economics study
on the role of non-credit institutions in EU mortgage markets**

Introduction

1. The Council of Mortgage Lenders (CML) welcomes the opportunity to comment on the London Economics study on the role of non-credit institutions in EU mortgage markets.
2. The CML is the representative trade body for the residential mortgage lending industry. Its 136 members currently lend over 98% of the residential mortgages in the UK mortgage market.

Our response

3. We welcomed the London Economics report. It demonstrates the diversity of national regulatory treatment for NCIs and the diversity of national market characteristics. Given this justified diversity we believe that it makes little sense to pursue regulation of NCIs at a European level.
4. In the UK, NCIs are regulated in respect of conduct of business and consumer protection rules on an equal footing to other lenders. In respect of prudential requirements, there is a different regime for NCIs than deposit takers as it is the act of taking deposits that is deemed to require the strictest prudential requirements. Nonetheless, there are prudential requirements for NCIs and they have proved effective at ensuring the continued operation of NCIs through the severely stressed environment we have experienced since summer 2007.
5. The experience of the US market, where NCIs, alongside banks, have been associated with poor quality lending sold on to investors through the securitisation market, risks polluting the view that regulators have of NCIs in Europe. This is an unfortunate comparison because the existing regulation of NCIs in the UK has ensured that these lenders have continued in business, fulfilling their commitments to existing customers. The risk to the financial system has come about in large measure because of deposit takers' exposure to US mortgage losses through RMBS and CDOs etc. rather than the activities of NCIs in Europe.
6. NCIs in the UK received no support from the government in the packages of measures announced on 8 October 2008 and 19 January 2009. Despite this and the lack of availability of the wholesale funding on which they were dependent for new lending, most have continued to operate, albeit, with severely curtailed new lending volumes. The fact that these institutions have continued to operate without government support through these extreme market conditions illustrates the robustness of the business model.
7. We recognise the need for regulators and policy makers to learn the lessons of the credit crisis. We accept that one of these lessons is that lenders should retain a material interest in the loans that they originate. Indeed, in the UK in contrast to the US, the practice of selling off the first loss interest was not widespread at all. But the proposed revision to the capital requirements directive (CRD) that would require investors to get an undertaking from the issuer or arranger that they will retain 5% of the same risk exposure as the investor, will seriously undermine the business model of many NCIs. We believe that it would make much more sense to require lenders, including NCIs, set an appropriate minimum first loss interest in securitisations instead.
8. Policymakers should concentrate on putting in place rules that ensure that all lenders have an on-going interest in the performance of the loans they originate and that capital requirements in the financial system are sufficient to absorb expected losses and prevent the system from operating with excessive pro-cyclicality.

Further contact

9. This response has been prepared by the CML. Comments and queries should be addressed to Rob Thomas, Senior policy adviser, telephone 020 7438 8934, email rob.thomas@cml.org.uk