

EBF OBSERVATIONS

ON THE STUDY ON THE ROLE AND REGULATION OF NON-CREDIT INSTITUTIONS IN THE EU MORTGAGE MARKETS

*Set up in 1960, the **European Banking Federation (EBF)** is the voice of the European banking sector, with over 30 000 billion EUR assets and 2.4 million employees in 31 members from EU and EFTA countries. The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.*

A. Introduction

The European Banking Federation (EBF) wishes to comment here on the study undertaken by London Economics on behalf of the EU Commission on the role and regulation of non-credit institutions. The study's purpose, as stated in the introduction by the author, is to inform the EU Commission on the reasons and background for the different national approaches to the regulation and supervision of credit and non-credit institutions in the EU. This informative approach is combined with the aim of exploring the potential barriers to the provision of cross-border lending by non-credit institutions in view of supporting further policy thoughts from the Commission on a passporting scheme for cross-border activity of such institutions.

Before commenting the content of the study, we would like to stress our appreciation for the EU Commission's commitment to first assess the market situation before taking any initiative in the area of mortgage lending, especially under the present circumstances. We commend this approach consistent with the better regulation principles as it is in our view indispensable for a sound policy making.

Nevertheless, we regret that the analysis could not be based on a larger spectrum of respondents and cannot thus deliver a more complete picture of the market (only 10 Other Mortgage Lenders – OMLs- in 7 Member States have provided input in particular on the cross-border activity). Conclusions drawn at this stage based on the study should, as a consequence, be carefully assessed before any policy decision on the matter is taken.

B. Specific Comments

Supporting competition

The European Banking Federation has constantly been supportive of a competitive and integrated financial market for the EU and mortgage credit is one of the main areas of retail finance where competition has to play its role in order to guarantee to providers a level playing field and the actual conditions for investing in the quality of their products, while delivering to consumers more choice and better prices.

We believe that competition in the mortgage credit sector, as in many others, can be ensured only subject to the respect of the golden rule for a workable competition, namely "*same business, same risk, same rules*" that has as a corollary an appropriate legal framework surrounding the active players in the sector.

The situation in the EU-27 presented by the study is not homogeneous from various points of view, be it the access to the profession, the funding systems allowed or the supervisory regime. We believe that, in order to ensure that a level playing field exists for all providers of mortgage credit – credit and non-credit institutions –, equivalent conditions have to be guaranteed in these three dimensions.

Access to the profession

We deem it indispensable that the access to the lending profession be under some form of control from the regulators in the EU. This aspect should not be dependent on the current level of presence or market share gained (or not) by non-credit institutions in a given market, since the assessment of the potential for growth and integration of the EU retail market should at least have a medium to long term perspective. In particular, the current financial crisis teaches us that loopholes in the regulation can represent a very high risk for the whole financial community on a global scale. A system of notification/registration should be in place in all EU Member States for providers that have not a banking license.

Conduct of business rules

Mortgage lenders that are not licensed as credit institutions should be subject to the same conduct of business rules than credit institutions. The mere fact of dealing with consumers should imply that consumer protection rules have to be complied with. This is even more important in the case of OMLs for which the target borrowers are particularly vulnerable consumers (households below 30 year and over 50 year old, subprime borrowers¹). The adherence to the voluntary Code of Conduct on Home Loans as well as the compliance with consumer protection rules in contractual terms cannot depend on the status chosen or the method of funding.

Safeguarding financial stability

One of the findings of the study is that the justification given by national authorities for the absence of prudential supervision or for a less stringent regime imposed on non-credit institutions active in mortgage lending is related to the lower risk represented by the latter because they do not take deposits from the public. We believe that OMLs should be submitted to an adequate prudential control in the EU.

The experience of the current crisis has shown that a funding base limited to own shareholding or subscribed capital is too volatile to be sufficiently stable and avoid systemic risk. Multiple funding systems should be allowed and guaranteed in at least an equivalent manner as they are for credit institutions according to the terms of the Capital Requirements Directive. Indeed, the risk for the borrowers and financial markets has been made evident by the subprime crisis even where deposits were not raised. Particular care should be used in the way securitisation is open to OMLs.

From another angle, equally important, a more stringent supervisory regime for OMLs would be required in cases where safeguards against illicit activities (money laundering, criminal activity financing) are not considered sufficient².

Cross-border activity

EBF would also like to address specific remarks with respect to the findings in the study on barriers to cross-border lending provision.

¹ See figure 7 in page 72 of the study.

² For instance, in Belgium the authorities were examining the need to implement stricter controls of OMLs in order to fill a gap in the regime for anti-money laundering as highlighted by a 2005 country report from the FATF/GAFI.

The lack of a uniform and more substantial supervisory control on OMLs across the various Member States may cause problems when a non-credit institution runs business on a cross border basis. Where only a *notification* is required from OMLs to the host country's authority in order to be able to provide lending services, there is no guarantee that the rules applied to OMLs in their country of establishment represent a sufficient guarantee of control. The host country's authority may not have, in this case, the powers to ensure that all the requirements set out by its own national legislation (not only prudential but also conduct of business rules) are fulfilled, if the home country regime does not have equivalent rules or does not impose them on OMLs. In these situations the cross-border nature of the activity may be a source of specific problems in the absence of a more harmonised regime of regulation/supervision on OMLs.

Besides, although we believe that deeper analysis should be conducted in this area since the study has reached only a limited representativeness, we would like to underline that many of the barriers identified or perceived for the cross-border activity by the interviewed OMLs do not appear very much different from those that credit institutions usually face. In other words, these are not barriers specific to OMLs and due to their status or the 'difficulty' in operating without a banking license, but rather barriers related to the structure of the markets in the EU.

Furthermore, the requirement of having a banking license is not the only factor that determines the chances to enter a foreign market. It is rather the overall profitability of cross-border lending and the business model chosen (direct trade, M&A, branches or subsidiaries network, distribution agreements) which remains one of the most important factors impacting the level of investment any lender is willing/able to do.

C. Conclusion

EBF considers fair competition and a level playing field as a pre-requisite for the correct, sound and safe functioning of the internal market. The current financial crisis cannot be disregarded in the evaluation of the market situation but should not be the benchmark for any policy choice with a long term range. A correct prioritisation and better regulation principles should guide any Commission's decision in this respect.

* * *