



FINAL DRAFT

25<sup>th</sup> of February 2009

**EMF comments on the London Economics Study on Non-Credit Institutions (NCIs) providing mortgage loans in the EU**

**I. Introduction**

1. The European Commission (EC) announced its intention to review the activities, regulation and supervision of mortgage lenders that are not registered as credit institutions<sup>1</sup> in the EU in the White Paper on the Integration of EU Mortgage Credit Markets. The EMF very much welcomes the publication of such a Study as it sheds some light on a relatively small yet growing part of the industry and provides a very useful and detailed survey of the situation across the EU's Member States.
2. The EMF also very much welcomes the opportunity which the EC has given stakeholders to comment on the contents of the Study. The EMF's views on NCIs expressed in this document are in line with the newly adopted EMF Strategy as a response to the current crisis. General comments are provided below, followed by country-specific requests for clarifications and/or corrections.
3. While the Study does not contain any policy proposals, the EC made it clear in the White Paper that its intention in surveying the role and regulation of non-credit institutions (NCIs) in EU mortgage markets was to assess whether action at Community level is needed.
4. In addition, in the press release accompanying the Study, Commissioner McCreevy explains that the publication will enable the EC to "assess whether there are any regulatory gaps in the supervision of EU mortgage lenders, and whether new measures are needed to address them". It also puts the Study in the context of the situation in the US, about which it reports that mortgage market participants with no federal supervision are said to have been responsible for the origination of more than 50% of sub-prime mortgages.
5. Thus, while the EC has communicated nothing yet about when it will express itself on whether EU action in this context is considered necessary - and if so, what form it will take - it can be expected that it will do so sometime in the near future. On this note, the EMF takes the opportunity to request more clarity from the EC generally on its planning on this matter.
6. Further, in anticipation of EC policy recommendations in this area, and in light of the situation in the US with regard to the regulation of such entities which the EC rightly highlights as an important contributory factor to the US sub-prime crisis, the EMF takes the opportunity of this response to reiterate its position with regard to the regulation of NCIs in the EU.

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<sup>1</sup> Note that the Study takes as its definition of credit institution, that which is provided by the Capital Requirements Directive 2006/48, i.e: "credit institution means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credit for its own account".

## II. General comments

### *i. Level playing field must be ensured*

7. In the White Paper itself, which was published in December 2007, the EC takes the opportunity to highlight that it is in favour of allowing NCIs to be active in the mortgage lending business, but deems it essential that responsible lending, financial stability and effective supervision are not in any way compromised.
8. The EMF is very much in agreement with such a view. On a number of occasions in the past, the EMF has similarly underlined the importance of ensuring that NCIs operating in the EU are effectively regulated and supervised<sup>2</sup>.
9. The EMF view is motivated by the belief that a level playing field must be ensured among all actors present in the EU mortgage markets and that, as such, adherence to the principle of "same business, same risks, same rules" is essential to avoid competitive disadvantage.
10. What this means with respect to all institutions providing mortgage credit to consumers, irrespective of whether they are banks or non-banks, is that they should be subject to the supervision of financial services authorities, and that conduct of business and consumer protection rules should apply equally to all.
11. One of the key markets targeted by NCIs is the non-conforming or sub-prime sector. Consumers in these market segments are often more vulnerable and may be less financially literate. It is therefore all the more important to ensure that existing consumer protection rules also apply to NCIs to maintain confidence in such a sector. Consumer protection issues such as pre-contractual information (adherence to the voluntary Code of Conduct on Home Loans) and contractual terms remain the same regardless of the funding method. On that basis the conduct of business rules for credit and non-credit institutions should also be the same.
12. According to the Study's findings, it is the case that in six Member States, domestic and foreign OMLs (non-credit institutions that are not insurance companies which provide mortgage loans) are not allowed to provide residential mortgage loans as the national legal frameworks limit the provision of mortgage loans to credit institutions (CIs). Reflecting on this finding, the EMF is of the view that mortgage lending in the EU should not in this way be limited to CIs as long as other entities are supervised and subject to the same rules with regard to conduct of business and consumer protection rules as CIs.

### *ii. Look closely at cases of regulatory differences*

13. One finding in the Study is that in Member States in which it is not necessary to be registered and authorised as a CI to provide mortgage loans, businesses will opt to register as NCIs rather than as CIs as capital requirements are lower for the former. Later, the authors of the Study explain that regulatory requirements for NCIs are at a less intensive level as compared to CIs because NCIs "do not take deposits and therefore the risks to the functioning of the financial system and to consumers is perceived to be low".
14. While it is true that NCIs do not have responsibilities towards depositors, this should not be perceived to mean that as a result they necessarily represent low risk to the

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<sup>2</sup> The EMF has in the past communicated its views on non-credit institutions in its responses to the report of the Mortgage Funding Expert Group as well as the Green Paper on the Integration of EU Mortgage Credit Markets.

financial system and to borrowers. The EMF therefore urges the EC to look critically into those Member States where such a situation of regulatory difference exists, to ensure that NCIs are regulated in an adequate and proportionate way, and that the risk which they represent is properly accounted for.

***iii. No discrimination between domestic and foreign entities***

15. As communicated in previous positions, the EMF also takes the opportunity to reiterate its belief that foreign NCIs offering loans in the EU should be authorised to do business across all of the EU's domestic markets, as long as they are subject to the same requirements as domestic NCIs.
16. It is therefore vital to ensure that a European passport for NCIs should not lead to a situation of regulatory arbitrage whereby foreign entrants are regulated less stringently than domestic actors.
17. Conversely, there should be no negative discrimination by national authorities preventing foreign NCIs from entering a domestic market and providing mortgage loans.

***iv. Pass-porting not a panacea***

18. The Study reveals that, as evidenced in the past for CIs, NCIs most commonly enter foreign markets by setting-up subsidiaries. The reasons for this are the same as for CIs, i.e. a preference for employing indigenous country workers who will be more familiar with the host country's compliance and regulatory frameworks. Thus, cross border challenges appear to be the same for both NCIs and CIs.
19. The Study then seems to suggest that neither changing to a CI status nor the pass-porting of NCIs would reduce the barriers to cross border mortgage provision, given that the obstacles to cross-border activity, i.e. such as differences in legal frameworks of Member States, diverging product authorisation and mortgage collateral regimes, etc. are not only relevant to CIs too, but are intrinsic to the diversity of European mortgage markets.

***v. CB funding the preserve of credit-institutions***

20. According to the Study, in two Member States (Estonia and the UK), NCIs are authorised to issue mortgage covered bonds for funding purposes. It should be highlighted that Art. 22 IV of the UCITS directive defines the minimum requirements that provide the basis for privileged treatment of covered bonds when these bonds are issued by a credit institution which has its registered office in a Member State. In addition, this is recognised as a necessity in 25 other Member States. NCIs should therefore not be allowed to issue covered mortgage bonds as this would hamper the quality risk requirements for such instruments and would negatively affect their rating and reputation, which is against the interests of the mortgage industry.

### III. Country-specific requests for clarification/Correction

#### *Sweden*

21. With regard to chapter 30, 30.1.1 (first paragraph), the Financing Operations Act (SFS 1992:1610) was annulled on the 1<sup>st</sup> of July 2004 and replaced with the Banking and Financing Business Act (SFS 2004:297). Companies wishing to provide mortgage loans must from the 1<sup>st</sup> of July 2004 notify Finansinspektionen, the Swedish FSA, according to the Obligation to Notify Certain Financial Operations Act (SFS 1996:1006).
22. On chapter 30, 30.1.1 (second paragraph): the Banking and Financing Business Act defines financing business as business which includes the receipt of deposits from the public and for e.g. the granting of credits. There is no other definition of financing business. On the other hand, the Act states what business a credit institution may carry out besides its core business (see Chapter 7, section 1). To obtain a correct description of the possibility for an insurance company to provide mortgage loans for insurance policy holders and non-holders alike the authors of the report are advised to approach the Finansinspektionen.