



EUROPEAN COMMISSION
IMPACT ASSESSMENT BOARD

Brussels,
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Opinion

Title

DG MARKT - Impact Assessment on: the proposal for a Directive on Responsible Lending and Borrowing of Mortgage Credit

(draft version of 20 August 2010)

(A) Context

The financial crisis underlined the importance of appropriate borrowing and lending decisions in mortgage markets. Accordingly, the Commission is planning a proposal dealing with those causes of irresponsible lending and borrowing of mortgage credit that arise at the pre-contractual stage (advertising and marketing, pre-contractual information, suitability and creditworthiness assessments, advice) or are linked to the scope of supervision (poor regulation and/or supervision of credit intermediaries and non-credit institutions). This initiative builds on the 2007 White Paper on the Integration of EU Mortgage Markets, follows up on G20 commitments to extend financial markets regulation and is part of the Commission response to the financial crisis. Other initiatives are planned or on-going for other causes of irresponsible borrowing and lending of mortgage credit, such as low levels of financial literacy, the tying of mortgage credit products to other financial products and mortgage funding.

(B) Overall assessment

The report provides the necessary evidence base for action in this area but should be improved in various respects. It should provide a clear definition of responsible lending and borrowing and assess the magnitude of the problems posed by inappropriate decisions in the EU mortgage markets for consumer protection, market integration and financial stability. On this basis, the report should strengthen the case for EU action and discuss in greater depth the proportionality of the preferred measures taking into account parallel initiatives to address excessive risk-taking in the financial markets. Finally, the report should clarify the analysis of impacts, explaining the factors underpinning the assumed decrease in the default rate and either revise the estimation of aggregate benefits or clearly highlight existing over- and under-estimations.

During the meeting DG MARKT agreed to revise the report in line with the recommendations of the Board.

(C) Main recommendations for improvements

(1) Provide an explicit definition of responsible lending and borrowing and clarify the magnitude of the problem. The report should explicitly indicate what is meant by "responsible" lending and borrowing. On this basis, it should clarify the magnitude of the problem in the EU, qualify its relevance relative to other causes of the financial crisis and assess the importance of the specific drivers addressed by the initiative in question. It should do so by drawing more extensively on available statistics, contrasting the EU situation with the US experience and providing specific examples of irresponsible lending and borrowing both before and after the crisis. In so doing, the report should better highlight the elements impeding self-correction by the market and present the available evidence regarding the possible channels for cross-country impacts, in particular for financial stability.

(2) Strengthen the analysis of subsidiarity and proportionality. Relying on improved evidence for the problems addressed, the report should strengthen the case for EU action. It should do this in particular with regard to consumer protection given that this is already high or being increased in several Member States, and financial stability given the low level of market integration and the limited evidence of cross-country spill-overs to date. The report should also discuss in greater detail why all measures are needed, also in view of the impact of parallel initiatives. The report should therefore explain why the introduction of requirements to deny credit in case of negative creditworthiness assessments and to issue warnings in case of poor product suitability would not be sufficient to prevent irresponsible borrowing and lending, especially considering the impact of other initiatives to reduce risk taking in financial markets (increased capital requirements, holding requirements for securitised products etc.). Finally, the report should more clearly present the extent of harmonisation implied by the various options with a view to facilitating the assessment of their proportionality.

(3) Clarify the analysis of impacts. The report should clarify the factors underpinning the quantitative estimates of benefits in terms of both their nominal level and their relative size. This is particularly relevant for the scale of the assumed impacts from the introduction of principle based guidance on remuneration schemes. The report should also explain more transparently how the aggregate sums for benefits and costs are calculated. It should in addition try to provide a more accurate figure for quantified benefits (for instance by assuming a certain ratio of economic harm to face value of mortgages if feasible) or clearly explain the existing biases in this estimation such as those arising from the fact that the recovery value of mortgage loans is not considered and that various benefits are not quantified. Finally, the report should analyze in greater depth the issue of reduced access for low-income households distinguishing between desired and undesired outcomes i.e. between protecting vulnerable households from irresponsible lending and reducing access to loans for creditworthy households because of the increased cost of granting such loans.

Some more technical comments have been transmitted directly to the author DG and are expected to be incorporated in the final version of the impact assessment report.

(D) Procedure and presentation

Both the main report and its annexes are very long and need to be further reduced, for instance by cutting section 4 and reducing the number of footnotes in the main text. A table comparing the assumed impact of various options on the default rate should be added to the main text. Finally, a sub-section explaining in detail how the report has been amended to take into account the points raised in this opinion should be included under section 2.

(E) IAB scrutiny process

Reference number	2009/MARKT/080
External expertise used	No
Date of Board Meeting	22 September 2010