

THE INTEGRATION OF THE EU MORTGAGE

CREDIT MARKETS

**Report by the Forum Group on Mortgage Credit
European Commission
Internal Market Directorate General**

This Report is published by the European Commission. The views expressed within it are views of the Group and its members, and not the European Commission.

Contacts

Mortgage Credit Forum Group Chair & Report Editors

Eric Ducoulombier: eric.ducoulombier@cec.eu.int, 0032(0)22965467

Harsha Shewaram: harsha.shewaram@cec.eu.int, 0032(0)22965174

**Internal Market Directorate General
European Commission**

© European Communities, 2004

Reproduction is authorised provided the source is acknowledged.

EXECUTIVE SUMMARY

1. The EU mortgage credit markets form a substantial part of the EU economy. At the end of 2002, the value of outstanding residential mortgage loans stood at 4 trillion Euro, approximately 40% of EU 15 GDP. They are markets where there is scope for further integration, albeit that views differ on the precise nature of this scope and the costs and benefits of such integration. Markets remain unregulated by sector specific legislation at EU level. The only intervention thus far at this level, has been the support by way of Commission Recommendation, for the establishment of the Voluntary Code of Conduct on Pre-Contractual Information for Home Loans ('the Code of Conduct').

2. In March 2003 the Commission created the Forum Group on Mortgage Credit with a three-fold mandate to:

- identify the barriers to the smooth functioning of the Internal Market for mortgage credit;
- assess the impact of such barriers on the functioning of the Internal Market; and
- make recommendations to the Commission to tackle these barriers.

3. This Report of the Forum Group presents its findings and Recommendations. The Commission has compiled and edited the Group's work to produce the Report, which reflects the thinking of the Forum Group and not the Commission. The Commission's views, including specifically its responses to the Forum Group's Recommendations, will be set out in a Communication due to be adopted in 2005.

4. The members of the Forum Group are experts from all stakeholder groups relevant to the mortgage credit market including the banking sector, consumer organisations, insurers, chartered surveyors and civil law notaries. The members have been chosen to reflect the geographical spread of the EU at the time of the Group's formation, EU 15, which has been the focus of this Report. The Forum Group has operated against the background of the wide-ranging review of the Financial Services Action Plan, which is designed to identify future Commission priorities in the area of Financial Services.

5. The Forum Group has focussed on five main areas considered by its members to be key to an assessment of the state of integration of the EU mortgage credit markets: Consumer Confidence, Legal Issues, Collateral Issues, Distribution Issues and Finance. The different views expressed by Forum Group members have been reflected by the Commission to produce a Report which is rich in variety as well as depth of coverage. Such views do not necessarily reflect the views of any federations or associations to which experts may belong.

6. The main focus of the discussions on Consumer Confidence was the issue of (further) binding consumer protection legislation and the costs and benefits of such legislation. Recommendations here focus on the need for further research and guidance in the area of EU mortgage credit, encouragement of provision of the kind of information covered by the Code of Conduct and harmonisation of key areas such as annual percentage rate charge and early repayment fees. Views differed on the precise nature of such harmonisation and related matters, leading to Industry and Consumer Representative specific Recommendations, as well as common Forum Group Recommendations. Within the Legal Issues discussions, a major topic was the proposed revision of the Rome Convention to enable free choice of law

in consumer mortgage credit contracts, a proposal hotly disputed by the Consumer Representatives in the Forum Group, because of the potential they considered it to possess, to have a detrimental impact on consumer confidence and protection. Other Recommendations in this area address matters as varied as credit databases, valuation standards and forced sale procedures. The Collateral Chapter includes a detailed assessment of the difficulties foreign lenders face in accessing national land registrations systems, with consequential Recommendations. Also encompassed within the Collateral Issues heading, are Recommendations intended to facilitate the transferability of mortgages, including a proposal that the Euromortgage concept be explored by the Commission. The Distribution Issues chapter surveys four distribution channels, including the relatively untested Internet channel, a channel identified by the Forum Group as having limited potential for expansion, albeit one which requires safeguards to ensure sufficient consumer protection and confidence. The concluding Finance chapter undertakes an in-depth analysis of the potential for a more liquid secondary market and for more efficient use of existing funding mechanisms, both regarded as vital to deliver the market conditions considered conducive to further integration of the EU mortgage credit markets.

7. The Forum Group's deliberations have resulted in forty eight wide-ranging Recommendations. The Commission is asked to review these Recommendations as a complete package, as action only on any individual Recommendation is considered to be incapable of delivering further integration of this market.

RECOMMENDATIONS

INTRODUCTION

1 The Commission should adopt a definition of cross-border lending and monitor it with statistical data.

CONSUMER CONFIDENCE

Common Recommendations

2 There should be Commission funded research on the costs and benefits of further integration of the mortgage credit market.

3 Provision of the kind of information currently provided by means of the European Standardised Information Sheet created by the Code of Conduct should be encouraged by the Commission and at a stage which facilitates use and comparison of such information.

4 Consumer Representatives and most Industry Representatives advocate harmonisation by the Commission of Early Repayment Fees. There is divergence on the nature of such harmonisation. For further details see Recommendations 10 and 18.

5 There should be harmonisation by the Commission of the Annual Percentage Rate Charge (APRC), in relation to both the method of calculation and the basis of calculation. There is divergence on the nature of such harmonisation. For further details see Recommendations 11 and 16.

6 There should be Commission funded research on the value from a consumer perspective of pre-contractual information of the kind provided by the European Standardised Information Sheet created by the Code of Conduct.

7 The Commission should create and maintain an on-line guide on the main legal and other issues on cross-border mortgage lending.

Specific Consumer Representative Recommendations

8 The Commission should encourage efforts to produce a standardised format for mortgage loan contracts.

9 The Commission should introduce binding consumer protection rules for mortgage loan contracts on a minimum harmonisation basis, set at the highest level, covering the following areas:

- Duty to give 'best possible advice'. The demands and needs of consumers and the underlying reason for all mortgage credit advice given to consumers regardless of source (including branches and intermediaries) should be specified to consumers on a durable medium .
- The right of the consumer to redress (judicial and extra-judicial).

- The provision of pre-contractual summarised information at the earliest stage of contact between the consumer and the lender or intermediary showing in a standardised European Standardised Information Sheet type format: commission charges, administration or handling charges, total amount borrowed and payable (including APRC, calculation rate, compound period, operation of variable interest rates and total interest payable), the cost of bundled products (direct and the impact on interest), form of product, the exposure period and cost of the Early Repayment Fee (including worked examples of the charge) and amortisation tables.

10 The Commission should ensure that consumers are afforded the right to terminate a mortgage agreement at any time and in any circumstances. Any charge levied on the consumer seeking to exercise this right must be: (a) appropriate in length of exposure (i.e. Early Repayment Fee charged beyond the first few years of the agreement must not be allowed); (b) calculated in a fair and objective manner to reflect the cost (if any) incurred by the lender in the wholesale markets and subject to a statutory ceiling; and (c) clearly indicated in the pre-contractual summary document using worked examples.

11 There should be harmonisation by the Commission of the Annual Percentage Rate Charge, in relation to both the method of calculation and the basis of calculation. Consumer Representatives favour a broad definition including all associated charges, and minimum harmonisation.

12 The Commission should ensure that redress and enforcement mechanisms/binding rules offer consumers a minimum equivalent protection throughout the EU, at the very least at the highest level currently in existence.

Specific Industry Representative Recommendations

13 The Commission is invited to exclude all secured loans from the Consumer Credit Directive proposal, in line with the European Parliament First Reading, to ensure that mortgages are not subject to two separate legal regimes.

14 In those jurisdictions which have binding rules on pre-contractual information for mortgage credit offers, the Commission should ensure that such rules are aligned with the European Standardised Information Sheet format, so that only one set of rules apply.

15 The Commission should ensure that the Code of Conduct continues to be maintained, in its current form of self-regulation. In any event, before any further assessment of its operation, the methodology for such assessment should be discussed by all stakeholders.

16 The Commission should harmonise the Annual Percentage Rate Charge, in relation to both the method of calculation and the basis of calculation. Industry Representatives favour a narrow definition restricted to costs levied by the lender for its benefit at the time of the granting of the loan, and full harmonisation.

17 The Commission should ensure that legally enforceable caps on interest rates and on the variation of interest rates are removed.

18 The Commission should ensure that legally enforceable caps on Early Repayment Fees are removed. There is support amongst some Industry Representatives for a proposal that there should be full harmonisation of the conditions for exercising the right of early repayment, especially for fixed interest rate loans, and limitation of that right to circumstances involving sale of the property, unemployment or death. All Industry Representatives advocate that lenders should be entitled to ask for full compensation of losses (especially those linked to funding) and costs resulting from the early repayment.

LEGAL ISSUES

19 The Commission should ensure that the applicable (substantive) law for the mortgage deed and any related security agreement is the law of the Member State where the property is located (*lex rei sitae*).

20 Industry Representatives advocate that the Commission should ensure that the applicable law for the mortgage loan contract is defined by a general conflict of law rule based upon the principle of free choice. The Rome Convention should be amended accordingly, provided that certain essential standards are met. Member States should no longer be able to seek to impose any additional national consumer protection rules to cross-border mortgage loan contracts. For further details see Recommendations 13 – 18 on Consumer Confidence.

21 Consumer Representatives do not agree with Recommendation 20 that the applicable law for the mortgage loan contract should be defined by a general conflict of law rule based on the principle of free choice and accordingly reject the proposal for such an amendment of the Rome Convention. Instead they recommend the retention of the specific rules on consumer protections contained within the Rome Convention and advocate the additional protection described in Recommendations 8-12 on Consumer Confidence.

22 The Commission should implement a short-term solution consisting of :

- collecting information on existing credit databases in all Member States;
- promoting the development of a Memorandum of Understanding between the owners/controllers of such databases, to facilitate access to national databases by foreign lenders on the same conditions as the access offered to domestic lenders and to facilitate data comparability; and
- . developing a project to assess the effectiveness of the Memorandum of Understanding during a pilot phase of 3-5 years.

23 The Commission should consider how to encourage Member States to develop positive (client indebtedness) as well as negative (level of default(s)) databases, taking into account the costs and benefits of such databases.

24 Industry Representatives advocate that the Commission should ensure that a financial institution which lends cross border is allowed to:

- accept valuations prepared according to internationally recognised valuation standards of its choice, without being subject to additional national conditions; and
- instruct any valuation practitioner who is a member of an internationally recognised valuation body to carry out the valuation, without being subject to additional national conditions.

25 Industry Representatives advocate that the Commission should ensure that a financial institution which lends cross border, and the valuer based in the country where the property is located, are able to accept mandatory regulations for standards or practitioners prevailing in either of their respective countries (mutual recognition of regulations).

26 Consumer Representatives advocate instead that the Commission should ensure that neutral international valuation standards prevail, or that there exists a single valuation standard ensuring comparability.

27 The Commission should recommend that high standards of valuation be made mandatory and that all valuation reports should consider core risk related criteria such as those recommended by the European Mortgage Federation (set out in Annex IV) where applicable.

28 The Commission should first:

- Perform an evaluation exercise of forced sales procedures within one year.
- Thereafter, monitor the functioning of forced sales procedures and assess results every three years. These results should be presented in the form of an official EU scoreboard on duration and cost of forced sale procedures in every Member State and lead to Commission advice/action for improvements.

29 Thereafter, if necessary, the Commission should promote measures to ensure that the duration of a forced sale procedure should not exceed a specified term, for example two years after the first step in the forced sale procedure.

COLLATERAL ISSUES

30 The Commission should ensure that:

- all charges affecting real estate must be registered in a Public Register in order to be binding on and take effect against third parties, regardless of their nature;
- the creation, modification or extinction of a charge on real property shall become effective vis-à-vis third parties only at the point of registration in the Public Register; and
- registered charges on real property in relation to the same estate shall rank in the order of priority disclosed in the Public Register.

31 For filings of applications for registration/notification, the Commission should allow Member States to decide that priority be determined according to the time at which the

application was received (not actual registration). In this scenario, the Member State should ensure that filings of applications must be registered or rejected by the Public Register in the order of receipt.

32 The Commission should ensure that Public Registers make all relevant information available to all parties or their representatives.

33 The Commission should ensure that Member States provide that the responsible Public Register certifying authority should have state indemnity. In the event that such responsibility is delegated to a third party, such party shall be covered by appropriate professional liability insurance for an adequate sum.

34 The Commission should ensure that Member States do not maintain or institute additional 'legalisation'/'validation' requirements, for authentic instruments formally drawn up in other Member States.

35 More generally, the Commission should provide financial support to the EULIS initiative, to enable and encourage its expansion across the EU.

36 The Commission should ensure that links between mortgage debts and the collateral security are made more flexible. In countries where there is an existing requirement for strong accessoriness between the loan and the collateral, this should be replaced by an accessoriness agreement in the form of a private agreement between the lender and the owner of the mortgaged property. The relationship between the loan and the collateral can be dealt with in such a way as to allow it to be tailored to fit the needs of the parties.

37 The Commission should ensure that Member States allow the lender or any beneficiary of a charge on real property, to appoint a representative (Mortgage Register Representative) vis-à-vis the Public Register. His/her position should be disclosed on the Register and not have any effect on the legal framework of the Register. He/she should be entitled:

- to establish any abstract of title;
- to consent to a change in the respective ranking of charges over the real estate in question and to grant preferential rights between beneficiaries as shall be deemed appropriate;
- to consent to, apply and file any registrations and notifications;
- to consent to any change or transfer of the charge on behalf of (and in the name of) the owner of the charge; and
- to act on behalf of the owner of the charge in relation to the discharge or cancellation of the charge.

38 The Commission should explore the concept of the Euromortgage, for example by way of a study, to assess its potential to promote EU mortgage credit markets integration.

39 The Commission should encourage Member States to increase the transferability of mortgages by introducing pan-European Security Trust instruments.

DISTRIBUTION ISSUES

40 The Commission should assess and ensure equal treatment of local banks and foreign banks on the basis of the same business, same risks, same rules principle.

41 The Commission should revise the legislation covering cross-border services and establishment of branches to include the establishment of representative offices, in order to ensure that there are no disproportionate barriers to the establishment of such offices.

42 The Commission should introduce a supervisory system for independent intermediaries along the following principles: registration with a competent authority in the home Member State; possession of appropriate professional knowledge and ability (to be determined by home Member State including requirement that the intermediary to be 'fit and proper'); possession of professional indemnity insurance and a complaint/redress scheme in line with requirements for other intermediaries to ensure consistency. In addition, Consumer Representatives advocated that under such a system there should be declaration at the outset of the relationship between consumer and intermediary of all payments including every commission/fee, and that records should be kept of any information/advice given to consumers. In the context of this Recommendation, Consumer Representatives pointed to the need to consider their Recommendation 9, in particular, with its reference to a 'best advice' standard.

43 The Commission should review what mortgage transaction actions require written processes and/or a physical presence generally and review money laundering legislation in particular, to address current legal barriers to greater Internet use.

44 The Commission should ensure consistency, especially in relation to information requirements, between different directives affecting financial services products.

FINANCE

45 The Commission should harmonise legislation regarding segregation of assets, in order to ensure equal access to securitisation for originators located in different jurisdictions.

46 The Commission should enact legislation that recognises the legal separateness of a securitisation vehicle from an originator of assets in the event of the insolvency/bankruptcy of such an originator, even if the securitisation vehicle is part of the same group of companies as the originator.

47 The Commission should investigate and address tax distortions, in order to ensure the removal of differences in fiscal treatment between local and foreign lenders.

48 The Commission should investigate and address national legislation which prevents or hinders the pooling of mortgage collateral from different issuers based in different jurisdictions.