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IMPACT ASSESSMENT
ANNEXES 1-5

Accompanying document to the

Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on credit agreements relating to residential property

(Text with EEA relevance)

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ANNEX 1 – Market description

1. INTRODUCTION

Household credit markets, covering mortgage credit and consumer credit, are an important element of the economy in all EU Member States. At the end of 2008, there was EUR 6.09 trillion outstanding in EU residential mortgage loans alone.[1] Among household credit markets, the market for residential mortgages is by far the most important one. In 2008, outstanding residential mortgage lending in the EU27 represented about 50 % of EU GDP[2]. In comparison, the market for unsecured consumer credit accounted in 2008 for 8.75 % of the EU GDP.[3] Furthermore, despite the financial turmoil, household credit markets continue to play a crucial role in the financial system. 32 % of total euro area monetary financial institutions (MFIs) loans at the end of 2008 were residential mortgages.[4]

Monetary financial institutions dominate the household financing business in the euro area, where 90 % of the stock has been originated by MFIs.[5] This contrasts sharply with the United Kingdom, where only 26 % of household financing was accounted for by MFIs. Distribution channels also vary considerably: in Finland, Malta and Sweden, the share of residential mortgages sold through credit intermediaries is around 1 %[6]. In contrast, in the United Kingdom, Ireland and the Netherlands, 70 %, 60 % and 45 % respectively of residential mortgages are sold through the intermediary channels.[7]

It is widely recognised that a mortgage credit linked to a house purchase is, for most EU citizens, the biggest financial investment of a lifetime. Mortgage debt to GDP ratios have however risen steadily across almost all EU countries in recent years[8] reflecting the higher value of household assets as well as rising numbers of mortgage borrowers. Mortgage debt is clearly the largest liability of euro area households, accounting for approximately 70 % of their total financial liabilities at the end of 2008.[9] In the EU27, in 2007, 12 % of consumers spent 40 % or more of their disposable income on housing[10]. Household debt may not be a problem in itself, as long as the levels of debt are sustainable. A survey[11] shows that 47 % of respondents said that they had problems to pay all their bills at the end of the month. Furthermore, 10 % of all households interviewed reported arrears of some kind[12]. The impact of this is an increase in default rates between end of 2007 and end of March 2009.[13]

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[1] *Hypostat 2008: A review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009.
[2] See footnote 1.
[3] ECRI Statistical Package, 2009.
[4] *Monthly Bulletin*, European Central Bank, July 2010.
[5] *Housing Finance in the Euro Area*, Occasional Paper 101, European Central Bank, August 2009.
[6] *Study on Credit Intermediaries in the Internal Market*, Europe Economics, January 2009, http://ec.europa.eu/internal_market/finservices-retail/docs/credit/credit_intermediaries_report_en.pdf.
[7] See footnote 6.
[8] *Structural Factors in the EU Housing Markets*, European Central Bank, March 2003.
[9] *Monthly Bulletin*, European Central Bank, August 2009.
[10] *EU-SILC*, Eurostat, 2007, http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Housing_indicators.
[11] *Europeans' state of mind*, Eurobarometer 69, November 2008.
[12] *Towards a Common Operational European Definition of Over-indebtedness*, Observatoire de l'Epargne Européenne in cooperation with CEPS and the University of Bristol, February 2008.
[13] Based on information provided to Commission services by Member States.

Member States experiencing an increase in default rates faced increases of varying severity, ranging from slight increases in countries such as France, Ireland and the Czech Republic to more than tripling in Spain and quadrupling in Estonia and Romania, and increasing tenfold in Latvia. Foreclosures have also risen in a number of Member States. However, considerable differences exist. For instance, while Austria, Cyprus, and Ireland have experienced a rather modest increase in the number of foreclosure procedures opened, Finland, Sweden, Slovakia, the United Kingdom and, in particular, Spain, Bulgaria and Denmark, have seen high increases.

Before the financial crisis, evidence collected by the Commission showed that interest in cross-border activity in the field of mortgage credit was small but growing.[14] The percentage of consumers purchasing cross-border[15] financial services was also limited. Anecdotal evidence suggests that the interest in cross-border activities has been significantly affected by the financial crisis as both lenders and consumers have focused on their domestic markets. Recent research however seems to indicate that the level of cross-border activity in the field of mortgage credit is higher than previously thought when considered in the broadest sense, i.e. mortgage loans provided by foreign credit institutions.[16] Other recent research also appears to indicate that cross-border activity in the field of mortgage credit may increase in the next five years.[17]

In conclusion, the integration of EU household credit markets remains limited. The level of direct cross-border lending remains low and a high level of heterogeneity still exists on various key aspects – the structure of underlying housing markets, available products and distribution channels. Despite these differences though, EU household credit markets face several similar challenges, namely increasing household debt levels and rising overindebtedness.

2. STRUCTURE OF EU MORTGAGE CREDIT MARKETS

2.1. Residential mortgage markets

EU residential mortgage credit markets represent an important element of the economy in all EU Member States. As of end 2008, there were EUR 6.09 trillion in residential mortgage loans outstanding in the EU.[18] The size of the national mortgage markets however varies considerably ranging from almost EUR 1.4 trillion in the United Kingdom and EUR 1.1 trillion in Germany to EUR 2.2 billion in Malta and EUR 3.9 billion in Bulgaria[19].

Growth rates in mortgage credit were sharply down on previous years in a large number of European countries, reflecting the ongoing economic and financial turmoil. The negative growth rate (-1.2 %) in residential mortgage loans in 2008 was sharply down from that of

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14 *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005.

15 Consumers may engage in cross-border activity in two main ways: locally via a foreign provider; or in another Member State via a range of distribution channels (e.g. intermediary, branch, subsidiary).

16 *Study on the costs and benefits of different policy options for mortgage credit*, London Economics with Achim Dübel (Finpolconsult) in association with the institute für finanzdienstleistungen (iff), November 2009. Based on a report by the ECB Task Force of the Monetary Policy Committee of the European System of Central Banks.

17 See footnote 6.

18 See footnote 1.

19 See footnote 1.

2007 (+7.9 %).[20] While most new Member States (e.g. Bulgaria, Romania, Poland, Slovakia and Slovenia all posted growth rates in 2008 in excess of 25 %) maintained high levels of growth, the three Baltic States and many EU15 countries (e.g. Spain, Ireland, United Kingdom and Italy) observed a sharp drop in mortgage lending, with Germany recording negative growth[21]. Growth rates fell further in Q1 2009 (compared with Q4 2008), with the United Kingdom, Sweden, and Germany recording negative growth[22]. By Q3 2009 most countries continued on the same trend as previous quarters, although most of the declines have shown signs of stabilisation[23].

Whether directly due to the economic and financial turmoil during 2007–2009, or as part of a longer-term market cycle in some instances, the face of EU mortgage markets has changed substantially in the last three years. In Ireland, according to the EMF the decrease in year-on-year gross residential mortgage lending in the first quarter of 2009 was 68.1 % on the previous quarter, while in Spain residential mortgage credit to households decreased by 34.1 % over the same period and by 63.7 % in the United Kingdom.[24] Following the same trend, Portugal showed a decline in gross residential mortgage lending of 53.1 %, France a fall of 43.5 % and Belgium a reduction of 18.2 %[25]. These decreases have continued into 2009 for many of the Member States, but there is also evidence suggesting a potential reversal in the trend. The picture is by no means uniform, however. In the first quarter of 2009, mortgage lending in Denmark grew by 17.5 % compared to twelve months before[26]. In the United Kingdom, according to the Council of Mortgage lenders, lending for house purchases showed its first material annual growth in July 2009 for the first time since early 2007.[27] Total gross lending rose significantly for the second month running, but was still 42 % lower than in July 2008.[28] Volume and value of loans for house purchase were 19 % and 6 % higher, respectively, in July 2009 compared to the same month the previous year.[29] Some caution will therefore have to be applied when extrapolating from recent trends.

2.2. Mortgage interest rates

Prices are an important indicator when monitoring market integration and competition. In an integrated market, prices should theoretically converge ('law of one price') because of competition between financial services providers. Generally, a perfectly integrated market is regarded as a market where prices for similar products and services converge across geographical borders and where supply and demand can react immediately to cross-border price differences. An integrated market should enable all participants (consumers, bank and lending institutions) to buy and sell credit products, which share the same characteristics, under the same conditions, regardless of the location of the participant. Price levels reflect differences in demand or cost structures and may also signal a less efficient market from the point of view of consumers due to the regulatory framework or the competitive environment.

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20 See footnote 1.
21 See footnote 1.
22 *Quarterly Review of European Mortgage Markets*, European Mortgage Federation, Q1 2009.
23 *Quarterly Review of European Mortgage Markets*, European Mortgage Federation, Q3 2009.
24 See footnote 22.
25 See footnote 22.
26 See footnote 22.
27 See http://www.cml.org.uk/cml/media/press/2397.
28 See footnote 27.
29 See footnote 27.

In general, the level of mortgage interest rates has fallen across Europe during the last ten years, driven largely by the reduction in nominal interest rates[30]. Interest rates have also converged[31], largely due to general macroeconomic convergence and the introduction of the euro[32].

Comparing the prices of retail financial products cross-border is, however, not without its difficulties. The different legal and economic environments in which products are offered mean that many of the key features of products, and thus the prices, differ[33]. This is particularly true for the Annual Percentage Rate of Charge (APRC) which incorporates not only the interest rate but other costs. As Graph 1 indicates, despite some degree of convergence, the Annual Percentage Rate of Charge on new mortgages still varies across Members States.

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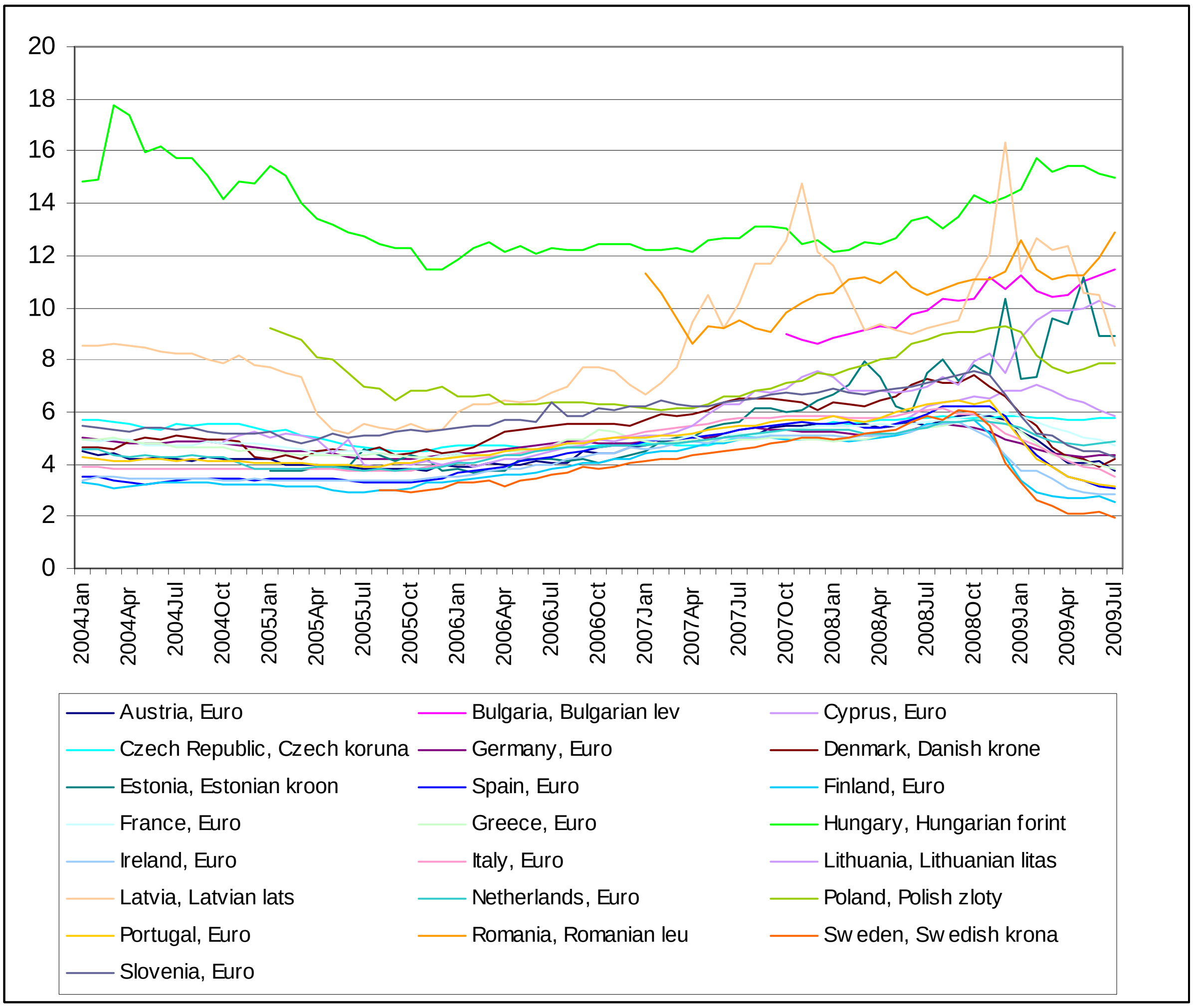
30 See for example, *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005; *European mortgage markets – 2006 adjusted price analysis*, Mercer Oliver Wyman and European Mortgage Federation, February 2006.

31 Several studies have also examined price convergence using different techniques (adjusted prices, non-adjusted prices, harmonised interest rates, etc.). Despite the different approaches, however, studies agree that – in general terms – there has been some convergence in the price of mortgage credit across Europe. See for example,
Financial Integration Monitor – 2005 – Background document, Commission Staff Working Document, June 2005;
Study on the Financial Integration of European Mortgage Markets, Mercer Oliver Wyman and European Mortgage Federation, October 2003;
European mortgage markets – 2006 adjusted price analysis, Mercer Oliver Wyman and European Mortgage Federation, February 2006;
Risk and Funding in European Residential Mortgages, Mercer Oliver Wyman and Mortgage Insurance Trade Association, April 2005;
Interim report II: current accounts and related services, European Commission, 17.7.2006.

32 *Financial Integration Monitor – 2005 – Background document*, Commission Staff Working Document, June 2005.

33 Features that may differ include the interest rate structure, tax, consumer risk profile, early repayment options (and costs), mortgage lenders fees, etc.

Graph 1: APRC loans for house purchase



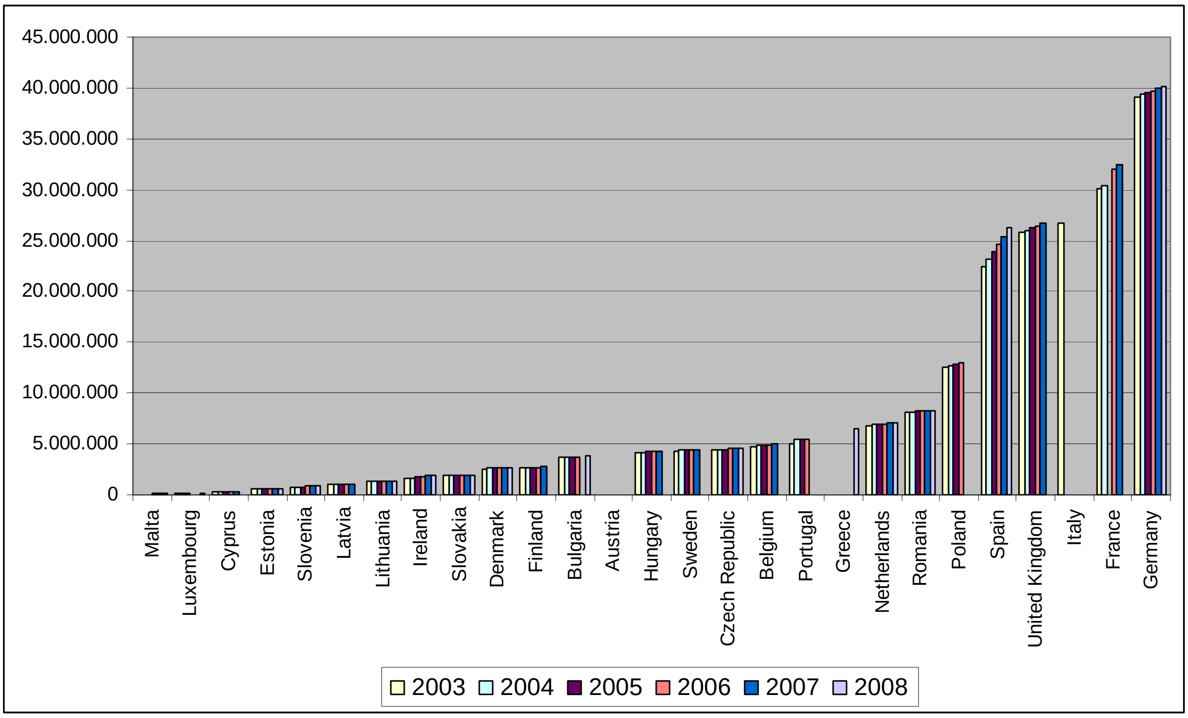
Source: ECB

2.3. Mortgage markets and housing markets

European mortgage markets and housing markets are closely linked. For instance, an increased demand for housing (i.e. due to population growth, a wider range of mortgage credit products available to potential borrowers, including non-prime borrowers, or a fall in interest rates) can put upward pressure on house prices, thereby increasing household assets. This may in turn lead to property owners 'trading-up' and/or withdrawing equity from their houses to finance e.g. consumption, thus compounding the initial effects. Conversely, a lack of consumer confidence in the economy at large or, more specifically, in the prospects for the housing market, as well as high levels of interest rates can deter consumers from house purchases.

The structure of EU housing markets also varies considerably. The following graph shows the total dwelling stock in the 27 Member States.

Graph 2: Total dwelling stock in EU Member States



Source: *Hypostat 2008: A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009

A slight increase in the housing stock can be observed in most Member States over the 5-year period, although some Member States, such as Spain, have seen a more dramatic increase than others.

Owner occupation of this housing stock varies considerably. As Table 1 shows, owner occupation rates range from 43.2 % in Germany to 97 % in Romania and Lithuania[34]. The share of rented dwellings in the total stock of housing has in general been falling in recent years[35]. This is likely attributable to a fall in the supply of rental accommodation due to the strictness of rent-related regulatory regimes and tax systems that are favourable to owner-occupied housing. Also, in recent years, due to falling interest rates, it has generally been more economical to buy than to rent[36].

34 See footnote 1.
35 See footnote 8.
36 See footnote 8.

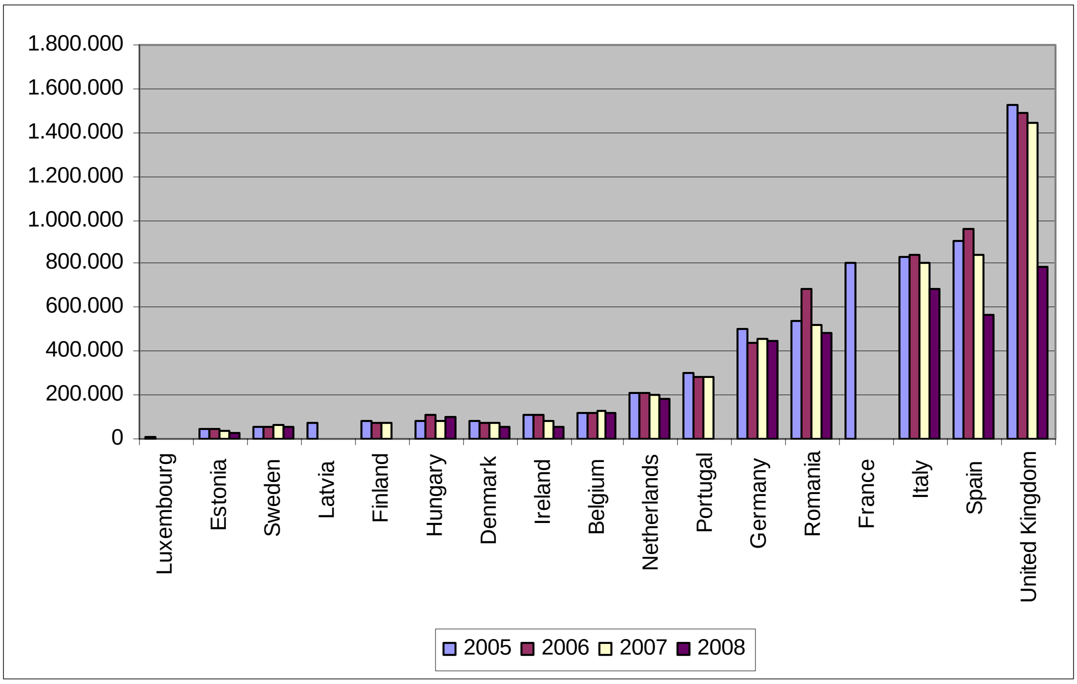
Table 1: Owner occupation rate (%)

Country	Latest available data	Owner occupation rate
Belgium	2007	78.0
Bulgaria	2002	96.5
Czech Republic	2007	58.7
Denmark	2008	54.0
Germany	2002	43.2
Estonia	2008	96.0
Greece	2008	80.6
Spain	2008	84.5
France	2007	57.4
Ireland	2008	74.5
Italy	2002	80.0
Cyprus	2006	68.0
Latvia	2007	87.0
Lithuania	2008	97.0
Luxembourg	2008	75.0
Hungary	2003	92.0
Malta	2006	75
Netherlands	2008	57.0
Austria	2003	57.0
Poland	2004	75.0
Portugal	2007	76.0
Romania	2007	97.0
Slovenia	2008	82.0
Slovakia	2008	88.0
Finland	2007	59.0
Sweden	2005	50.0
United Kingdom	2007	52.0
EU27 average		66.8

Source: *Hypostat 2008: A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009

The number of housing transactions also varies considerably across Europe, as shown by the following graph.

Graph 3: Number of transactions in EU Member States



Source: Latest available data from *Hypostat 2008: A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009

Until 2007, the United Kingdom was by far the most active country with approximately 1.44 million housing transactions, which is almost twice as many as in other big Member States such as Spain, France and Italy. Germany, despite its size, accounted for approximately 455 000 transactions. In 2008 however, the number of housing transactions fell as consumers held off from property transactions due to the increasingly uncertain economic and financial climate. For instance, in France, transactions on existing homes fell by an estimated 30 % in the year to June 2009[37]. In Spain, in 2008, transactions were about 30 % lower year-on-year, and in the United Kingdom, sales volumes were down about 50 % year-on-year[38]. There are some initial signs however that this course may be turning: in October 2009, it was observed that the number of transactions in the United Kingdom was up 10 % from the level recorded one year earlier[39].

House prices have generally increased over the last twenty years in most of EU countries[40]. The increase in house prices results in consumers borrowing more money to buy houses, thereby increasing the share of household income spent on houses. However, in some countries, the picture is more mixed. For example, in United Kingdom, France and Ireland house prices have seen significant falls (-16 %, -10 % and -9 % respectively, year-on-year at the end of 2008)[41], while Spain saw house prices fall about 3 % year-on-year and German house prices fell by 2.2 % by the end of 2008[42]. In contrast, house prices in the Netherlands

37 *European Housing Review*, RICS, February 2010.
38 See footnote 1.
39 See footnote 37.
40 See footnote 8.
41 *European Housing Review*, RICS, February 2009.
42 See footnote 41.

were relatively flat, and in Italy, they rose by 1 %[43]. In 2009 a different picture emerges: with prices recovering in some countries and growing up to 8.5 % from their through in for example the United Kingdom[44].

3. DISTRIBUTION CHANNELS

3.1. Financial institutions

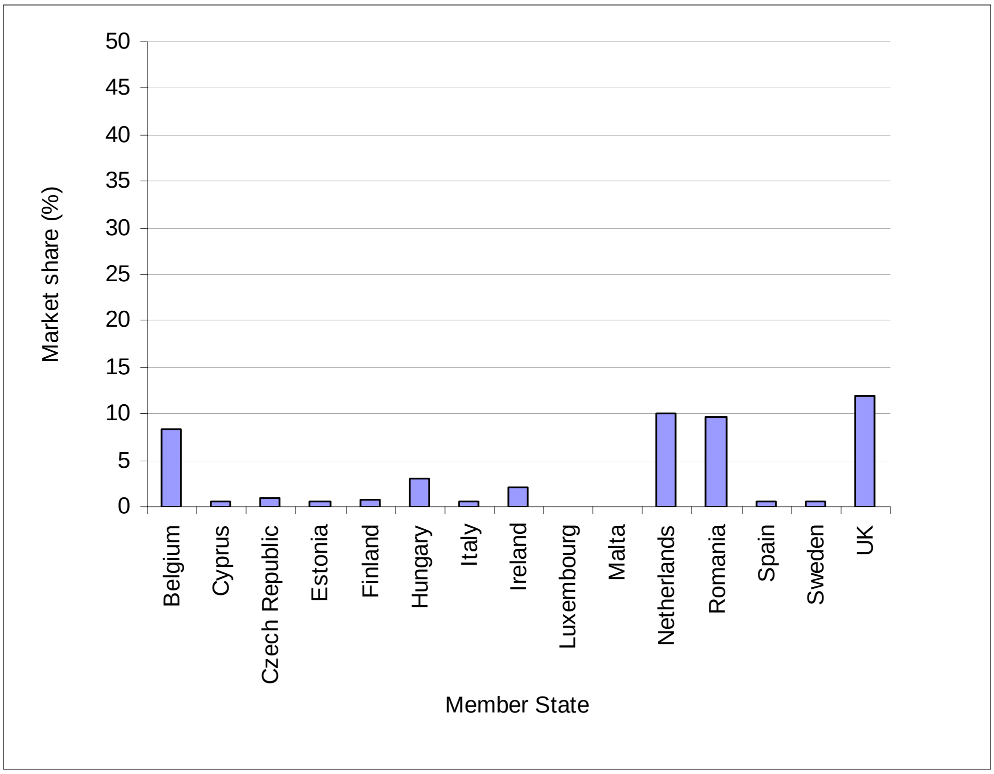
Lending to households in euro area countries is predominantly provided by MFIs, reflecting the bank-oriented structure of the financial system. In the euro area, the MFI sector accounted for approximately 85 % of total household financing in 2007.[45] The corresponding contribution of the MFI sector to total household financing in the United Kingdom and the United States was 26 % and 31 % respectively.[46] The dominance of MFIs is particularly true for loans for house purchase: in the euro area, more than 90 % of the stock was originated by euro area MFIs.[47]

3.2. Non-credit institution lenders

Non-credit institutions (NCIs) active in mortgage lending include insurance companies and other mortgage lenders. Information on the market shares of NCIs is limited. While six Member States do not allow mortgage lending by NCIs[48], national statistics in most other Member States only report mortgage loans provided by credit institutions. Graph 4 depicts an informed estimate of the market shares of NCIs (excluding insurance companies) providing mortgage credit in fifteen Member States.

43 See footnote 41.
44 See footnote 37.
45 See footnote 5.
46 See footnote 5.
47 See footnote 9.
48 Germany (insurance companies are an exception), Greece, France, Austria, Portugal and Slovakia. *Study on the role and regulation of non-credit institutions in EU Member States*, 2009, London Economics.

Graph 4: Market share of NCIs in national residential mortgage markets



Source: *Study on the Role and Regulation of Non-credit Institutions in EU Mortgage Markets*, London Economics, September 2008

Note: The market share for Belgium is for the year 2006. Hungary reported an estimate for 2006 (3 %) and 2007 (4 %). The United Kingdom reported a market share of 12 % for 2006 and 2007.The Member States that reported OMLs as marginal players in the mortgage market are shown with a market share of 0.5 %.

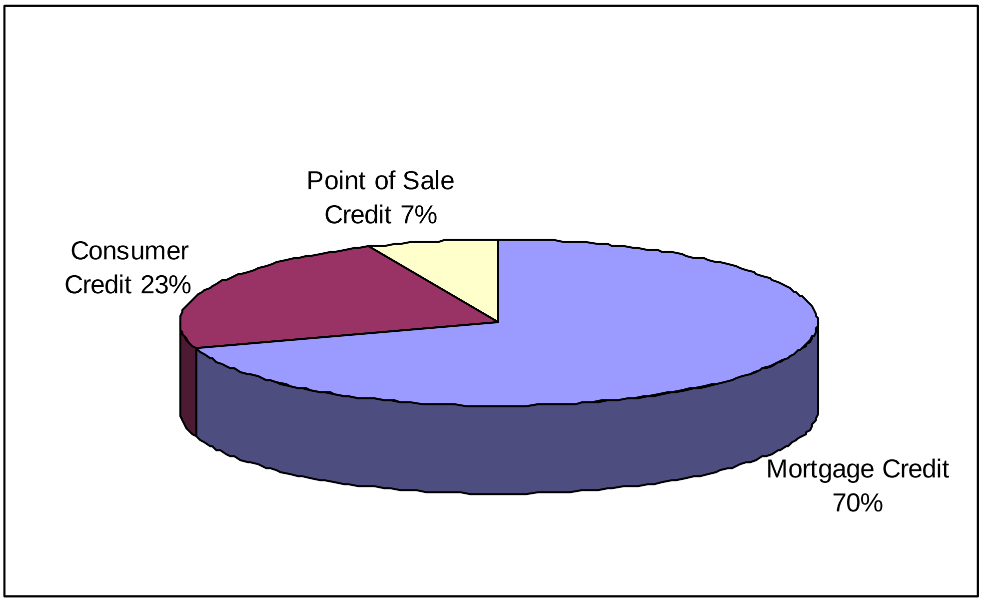
The market share of NCIs in the Member States' national mortgage markets is small to very small compared to the market share of credit institutions.[49] NCIs in the United Kingdom have the highest market share (12 %), followed by the Netherlands (10 %), Romania (9.7 %), and Belgium (8.4 %).

[49] See *Study on the role and regulation of non-credit institutions in EU Mortgage Markets*, London Economics, September 2008. It should be noted that of 20 Member States allowing non-credit institutions, only 15 Member States were able to provide data on the estimated market share of non-credit institutions.

3.3. Credit intermediaries

Between 2006 and 2007, credit intermediaries were involved in the intermediation of EUR 564 billion worth of residential mortgages.

Graph 5: Repartition of types of credit offered by credit intermediaries in 2007



Source: *Study on Credit Intermediaries in the Internal Market*, Europe Economics, January 2009

For the EU27 as a whole just over 40 % of mortgage credit lent was through credit intermediaries.[50] However, it should be noted that this figure was heavily influenced by the high penetration in the UK market (and by the relative importance of the UK mortgage market — although as noted above the size of the UK market has in any event declined significantly during the course of 2008).[51] There are significant variations in the market share of mortgage credit intermediaries across the EU. The volume of mortgage credit provided via credit intermediaries is particularly low (<10 %) in Cyprus, Denmark, Finland, Estonia, Latvia, Lithuania, Malta, Sweden.[52] In contrast, it is particularly high in countries such as the United Kingdom (70 %), Ireland (60 %), the Netherlands (45 %), Austria (35 %) and Germany (32 %).[53] Other countries have a more average market penetration (Belgium, Bulgaria, Czech Republic, France, Hungary, Italy, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia, Spain)[54].

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[50] See footnote 6.

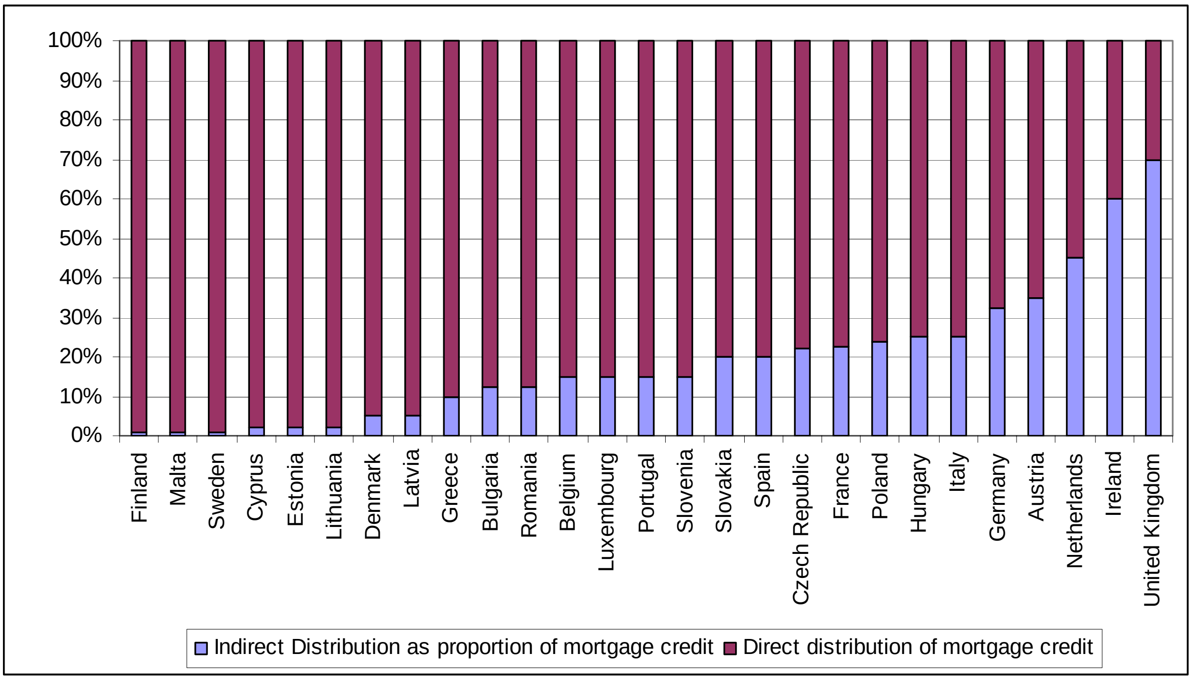
[51] See *DP09/3 Mortgage Market Review*, Financial Services Authority, 2009, for more information on the situation of intermediaries in the United Kingdom.

[52] See footnote 6.

[53] See footnote 6.

[54] See footnote 6.

Graph 6: Distribution of mortgage credit in 2007



Source: *Study on Credit Intermediaries in the Internal Market*, Europe Economics, January 2009

This divergence in the penetration of credit intermediaries within EU mortgage markets can be explained by the degree of concentration of the banking sector, the perceived extent of competition in the mortgage market and the ratio of population to individual bank branches and the level of regulation in Member States[55].

4. CROSS-BORDER ACTIVITY

Financial services providers can supply mortgages cross-border in several ways: through local presence (e.g. branches, subsidiaries, mergers and acquisitions); through direct distribution channels (e.g. via telephone or the Internet); or through local credit intermediaries (e.g. brokers). Financial services providers can also engage in cross-border activity by purchasing a mortgage portfolio from a mortgage lender in another Member State.

4.1. Mortgage credit providers

Information from both consumers and mortgage lenders respectively confirms the fact that most mortgage transactions are conducted locally, with virtually no EU consumers purchasing mortgage products cross-border[56]. One survey of pan-EU mortgage lenders found that physical presence is particularly important in the mortgage business since most sales are conducted via branches[57]. This confirms the results of earlier studies which found that those mortgage lenders that operate in other EU Member States do so mainly through branches in

[55] See footnote 6.

[56] See for example, *Consumer protection in the internal market*, Eurobarometer 298, October 2008; *Public Opinion in Europe – Financial Services*, Eurobarometer 205, January 2004; *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005.

[57] See footnote 14.

the host country[58]. However, foreign presence varies considerably between different Member States: foreign branches and subsidiaries controlled 70.3 % of the total assets in new Member States in 2007, while they held only 27.8 % of total assets in the EU15[59]. In France, Spain and Germany, less than 10 % of housing loans are provided by foreign credit institutions.[60] This contrasts to Luxembourg, Finland and Slovenia.[61] According to research, this share of housing loans suggests that there is a relatively high level of cross-border mortgage provision (in the broadest sense).[62] Other research also indicated increased international competition in other Member States.[63]

According to the limited information available on this issue, cross-border provision of residential mortgage loans through NCIs is greater than for credit institutions. According to data from UK Financial Services Authority[64], in 2006, 64 % of mortgage loans provided by NCIs were provided by foreign NCIs; in 2007 this figure was 59 %.[65] In comparison, in the case of mortgage loans made by credit institutions, 12 % of these loans were from foreign credit institutions in 2006 and 15 % in 2007.[66]

Before the financial crisis, a majority of lenders expressed a significant interest in developing their activities in countries where they did not already have a subsidiary or branch presence[67]. Establishing a branch or a subsidiary appears the most common form of interest in developing a cross-border business but mortgage lenders also expressed a relatively high interest in merging with or acquiring an existing mortgage lender[68].

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58 See footnote 14.

59 *EU Banking Structures*, European Central Bank, October 2008.

60 See footnote 16.

61 See footnote 16.

62 See footnote 16.

63 *Study on the costs and benefits of different policy options for mortgage credit*, London Economics with Achim Dübel (Finpolconsult) in association with the institute für finanzdienstleistungen (iff), November 2009. Based on a report by Mercer Oliver Wyman from 2007.

64 The FSA was the only regulator able to provide data on cross-border lending by non-banks. See *Study on the role and regulation of non-credit institutions in EU mortgage markets*, London Economics, September 2008.

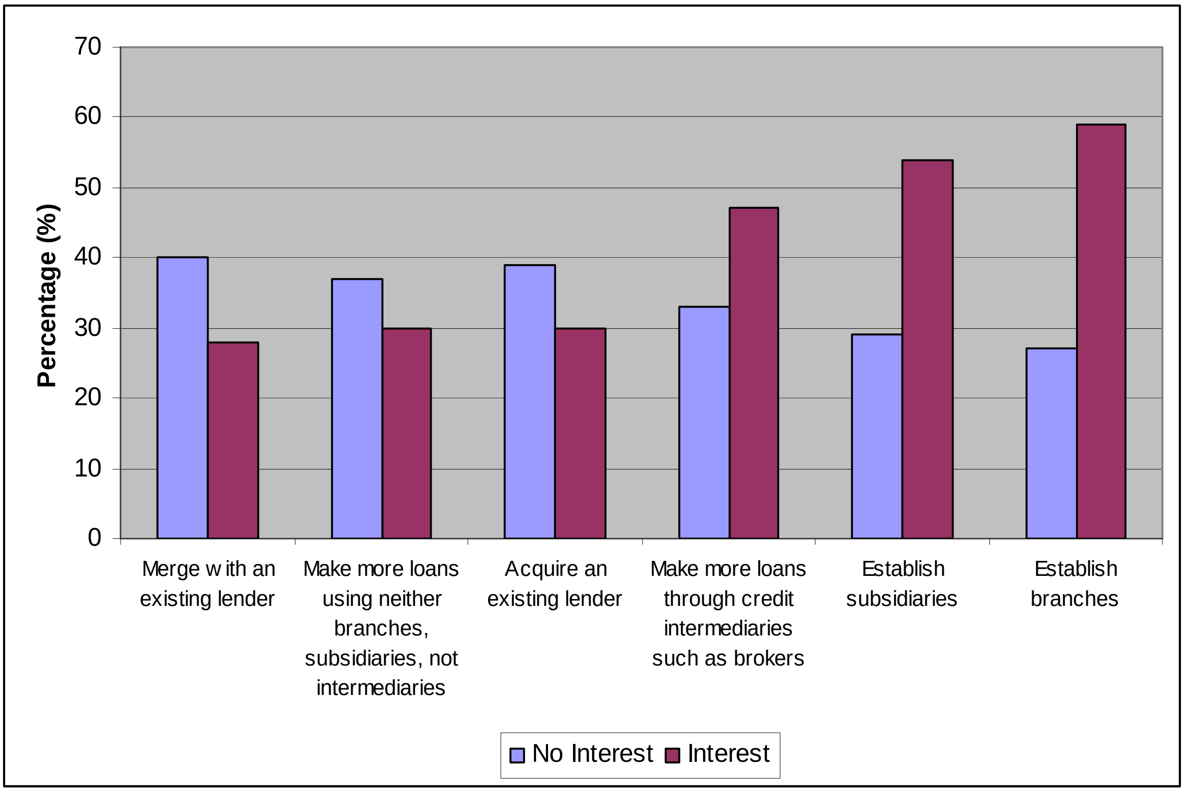
65 Many of these NCIs are UK subsidiaries of US financial services firms that operate on global scale. However, the study also provided several case studies. One institution surveyed stated that they provided mortgages accounting for 10 % of the value of their total mortgage portfolio in 2007 in two EU Member States and another none-EU country besides its home country. Three other NCIs reported cross-border activity in the EU but were unable to provide data, *Study on the role and regulation of non-credit institutions in EU mortgage markets*, London Economics, September 2008.

66 *Study on the role and regulation of non-credit institutions in EU mortgage markets*, London Economics, September 2008.

67 See footnote 14.

68 See footnote 14.

Graph 7: Strategies of firms in next five years in EU countries where they have no subsidiary or branch presence



Source: *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 61

Alternative distribution channels, such as the Internet or credit intermediaries are also increasingly being used to engage in cross-border activity. One survey of financial services providers found that 11 % of the surveyed mortgage lenders reported making a 'substantial' number of loans to borrowers in countries where they had neither a branch nor a subsidiary, with another 32 % doing so rarely[69].

Almost half the mortgage lenders questioned in the same survey reported that they were interested in making more mortgage loans through credit intermediaries in another EU Member State in the next five years, making this the third most popular strategy after the establishment of subsidiaries and the establishment of branches[70]. 30 % of providers were also interested in cross-border activity in another EU Member State in the next five years, using neither branches/subsidiaries nor credit intermediaries, thereby illustrating some potential for direct cross-border activity via for example the Internet or telemarketing in the future[71]. Mortgage lenders from the new EU Member States expressed a greater interest in entering a foreign market using direct cross-border trade and credit intermediaries than mortgage lenders with their home base in the EU15, who preferred using subsidiaries[72]. The survey of mortgage lenders already active EU-wide also indicated that although the use of the Internet and

69 See footnote 14.

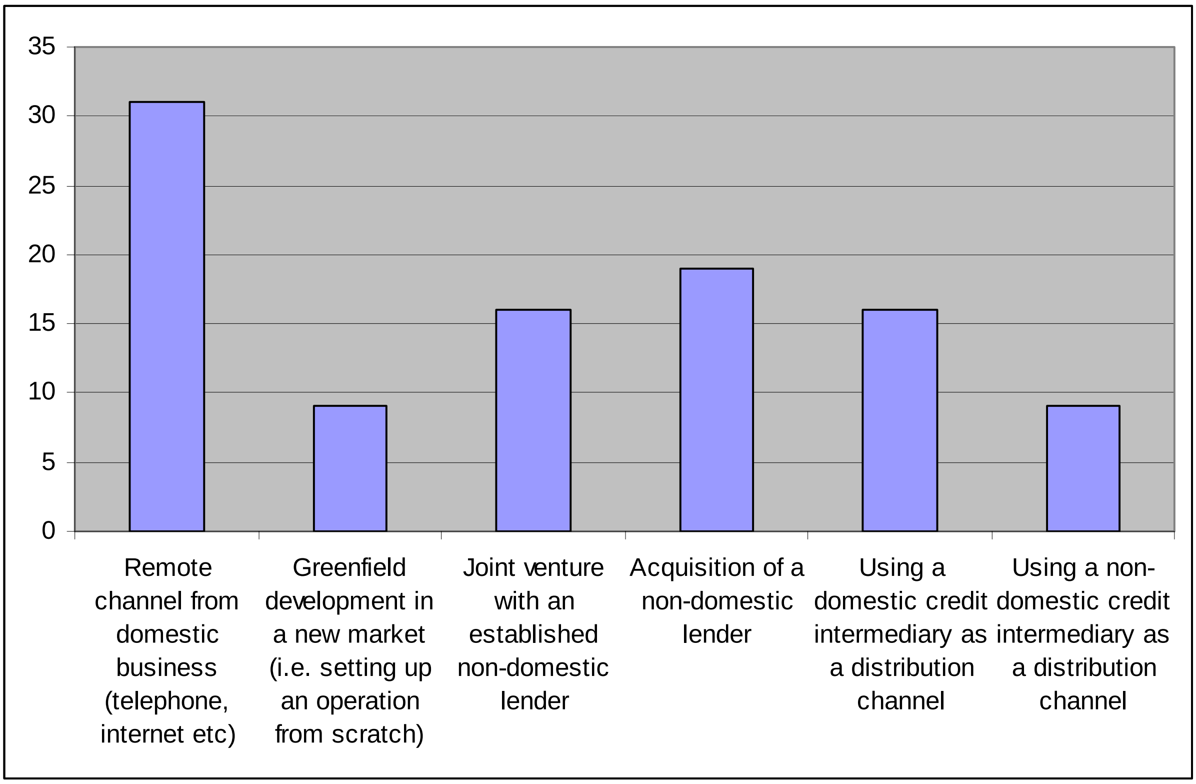
70 See footnote 14. 33 % of lenders expressed strong or some interest to establish subsidiaries, 32 % to establish branches and 31 % through the use of credit intermediaries.

71 See footnote 70.

72 See footnote 70.

telemarketing remains small, it is an area of the business that mortgage lenders would like to develop in the future[73].

Graph 8: The relative attractiveness of approaches to cross-border activity



Source: *Study on Credit Intermediaries in the Internal Market*, Europe Economics, January 2009, p. 261. These results are based on responses from 25 lenders from a range of Member States (France, Belgium, United Kingdom, Sweden, Germany, Italy, Czech Republic, Portugal, Spain and Hungary).

A survey by Europe Economics on behalf of the Commission, illustrated that stakeholders believed that credit intermediaries would increase in importance as a distribution channel for such cross-border activity over the next five years, with the total level of cross-border trade also expected to weakly increase.[74] The exception to this was consumer credit intermediation where providers from a number of Member States (including Belgium, Lithuania and Slovenia) expected sharp declines in cross-border activity generally and the importance of credit intermediaries in particular.[75]

4.2. Consumers

The percentage of consumers purchasing cross-border[76] financial services is limited. This is particularly true for mortgage products, with virtually no EU consumers purchasing mortgage products in another Member State, although in some Member States such as the Netherlands, Belgium and Luxembourg this figure is very slightly higher (1 %)[77]. A limited range of

[73] See footnote 70.
[74] See footnote 6.
[75] See footnote 6.
[76] See footnote 15.
[77] *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005. It should be noted that this figure excludes consumers purchasing a mortgage locally to finance a property abroad.

products may, however, be offered to domestic consumers to purchase a property abroad. Surveys indicate that although the majority of consumers intend to continue to shop locally for their mortgages, 3 % would consider obtaining a mortgage from a firm located in another country of the EU within the next five years[78]. This number however varies in size depending on the country, with consumers from countries such as United Kingdom (9 %), Ireland (8 %), Finland (6 %), France and Austria (both 5 %) being more likely to consider going cross-border for mortgage credit. In addition, according to a survey of EU consumers by London Economics many respondents (70 % of consumers interviewed) would consider to switch to products with a lower rate and/or greater product flexibility and/or other features of interest being offered in another Member State[79].

Anecdotal evidence suggests that the financial crisis has undermined consumer confidence and thus in turn reinforced the 'domestic bias' – the preference of consumers to buy financial products in the national domestic market. However, it can be assumed that consumer confidence and also the propensity to choose a non-domestic provider will, in the medium term, return to a pre-crisis level.

The reasons why the large majority of consumers still do not express a demand for cross-border products should be examined in more detail. According to a Eurobarometer survey, almost a quarter of those surveyed did not believe it possible to obtain a mortgage in another EU Member State[80]. Another Eurobarometer asked consumers what they see as the main barriers to shopping for financial services cross-border[81]. Although 29 % of consumers cited language barriers, around one quarter of consumers surveyed felt that a lack of information is an obstacle for consumers using financial services elsewhere in the EU[82]. Just over 10 % also felt that poor legal protection in the event that something goes wrong was an obstacle for consumers[83].

5. INDEBTEDNESS

Retail financial services are essential for the everyday lives of EU citizens. It is widely recognised that a mortgage credit linked to a house purchase is, for most EU citizens, the biggest financial investment of a lifetime and most European consumers have some form of consumer credit, e.g. credit cards.

An examination of the mortgage/consumer credit debt to GDP ratio illustrates the importance of credit to the economy at large. It also however may be used as an indicator of the absolute level of indebtedness of consumers. As is illustrated in Graph 9 below, total credit to households has developed differently for different Member States over recent years. While, for instance, total household debt expressed as a percentage to GDP has more than doubled in several new Member States (e.g. Slovakia, Romania, and Lithuania) between 2005 and 2008,

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The survey covered the population of the respective nationalities of the European Union Member States, resident in each of the Member States and aged 15 years and over.

78 *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005. Respondents were asked whether they consider obtaining financial services from a firm located in another country of the European Union within the next five years.

79 See footnote 14.

80 *Internal Market – opinions and experiences of citizens in EU25*, Eurobarometer 254, October 2006.

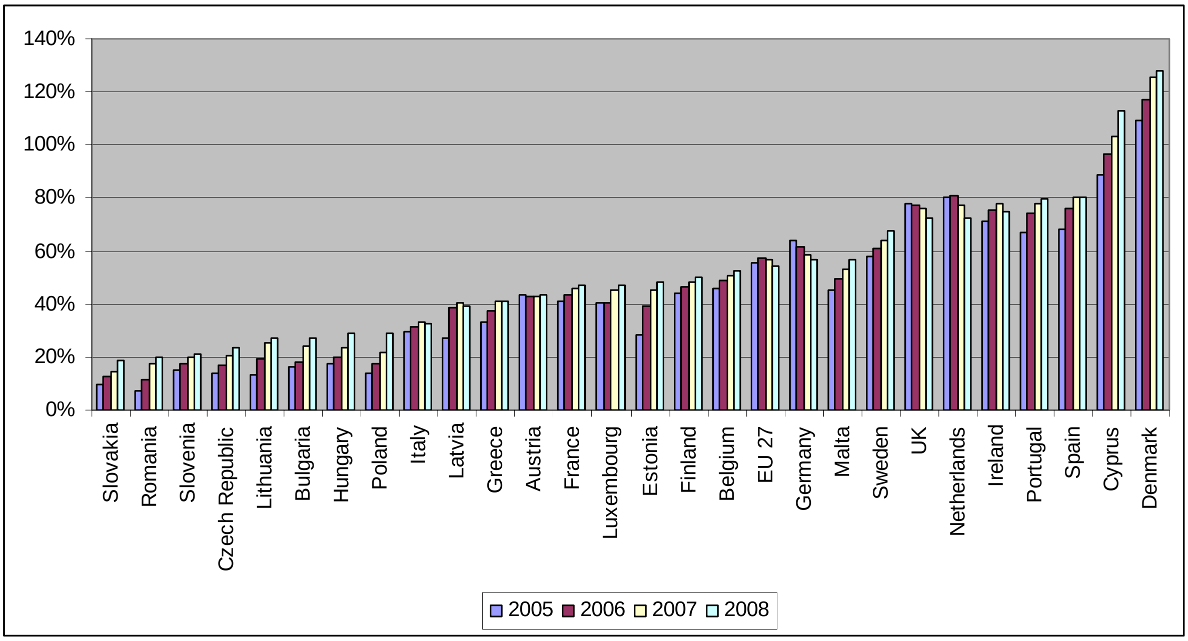
81 *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005.

82 See footnote 81.

83 See footnote 81.

it has been decreasing significantly in the Netherlands.[84] In the same period, the proportion of total household credit to GDP for the EU as a whole has stabilised. After an increase from 55.29 % in 2005 to 57.15 % in 2006, it amounted to 54.25 % in the year 2008.[85]

Graph 9: Development of total credit to households in EU27 (% of GDP)

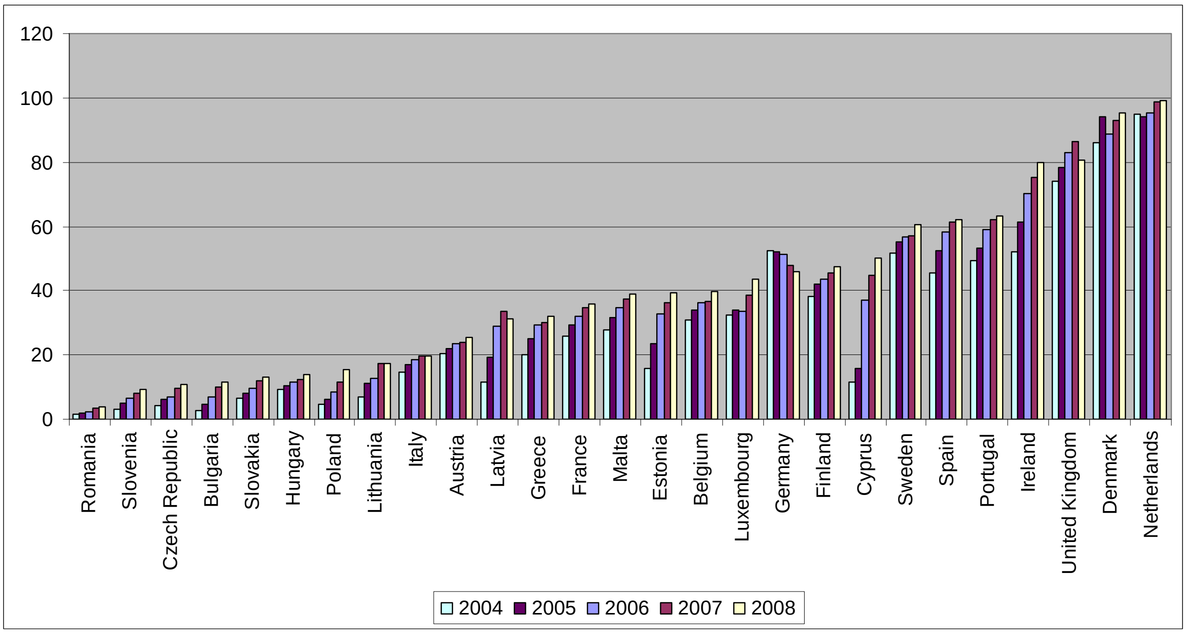


Source: ECRI Statistical Package, 2009

The economic significance of EU mortgage credit markets is clear: outstanding residential mortgage credit balances represent about 50 % of the EU GDP[86] while mortgage debt as a percentage of national GDP varies considerably. Mortgage credit represents almost 100 % of GDP in the Netherlands, while it amounts to only 4.0 % and to 9.1 % of GDP in Romania and Slovenia respectively.[87] Mortgage debt to GDP ratios have however risen steadily across almost all EU countries in recent years[88] reflecting the higher value of household assets as well as rising numbers of mortgage borrowers. This higher level of indebtedness can be attributed to a range of different factors including increasing residential investment, higher income expectations, falling interest rates and favourable tax treatment for mortgage loans[89]. Furthermore, throughout the 1990s and the early 21st century, product innovation and the increased use of capital market funding to finance these new products has led to improved access to mortgage credit for previously credit constrained households leading to higher mortgage commitments. In addition and, despite the financial crisis of the last couple of years, residential mortgage debt to GDP ratio has continued to rise in the vast majority of EU countries.

84 See footnote 3.
85 See footnote 3.
86 See footnote 1.
87 See footnote 1.
88 See footnote 8.
89 See footnote 8.

Graph 10: Residential mortgage debt to GDP ratio (%)



Source: *Hypostat 2008: A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009

Mortgage debt is clearly the largest liability of euro area households, accounting for approximately 70 % of their total financial liabilities at the end of 2008.[90] Moreover, focusing in particular on MFI loans to households, the share of loans for house purchase in total household debt has been on an increasing trend, rising approximately 20 percentage points since the early 1990s, to reach 72 % in 2008.[91]

The annual growth rate of MFI lending to households for house purchase in the euro area remained at double-digit levels throughout the 1999–2007 period, with the average annual growth rate standing at 11.5 %. The strong dynamics of mortgage lending during the period led to a significant rise in the indebtedness of euro area households as regards loans for house purchase, from approximately 25 % of nominal GDP at the beginning of 1999 to 40 % in the last quarter of 2007.[92] While the increase in mortgage debt is a feature shared among all euro area countries, the size of this increase has varied quite considerably. To some extent, this reflects the different initial levels of indebtedness, with some of the countries where indebtedness was low at the beginning of the period, such as Slovenia or Greece, witnessing very high average growth rates of MFI lending to households for house purchase (more than 25 %).[93]

Residential mortgage debt per capita also increased substantially during the housing boom across Europe.

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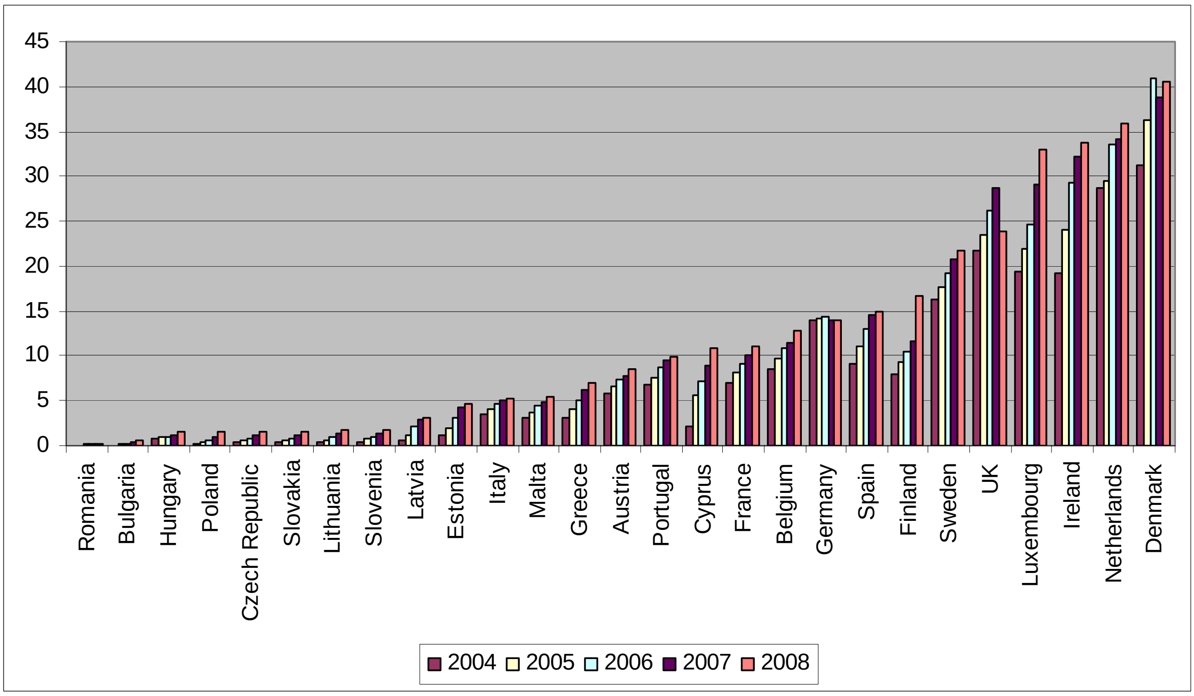
90 See footnote 5.
91 See footnote 9.
92 See footnote 9.
93 See footnote 9.

Graph 11: Residential mortgage debt per capita (EUR thousands)

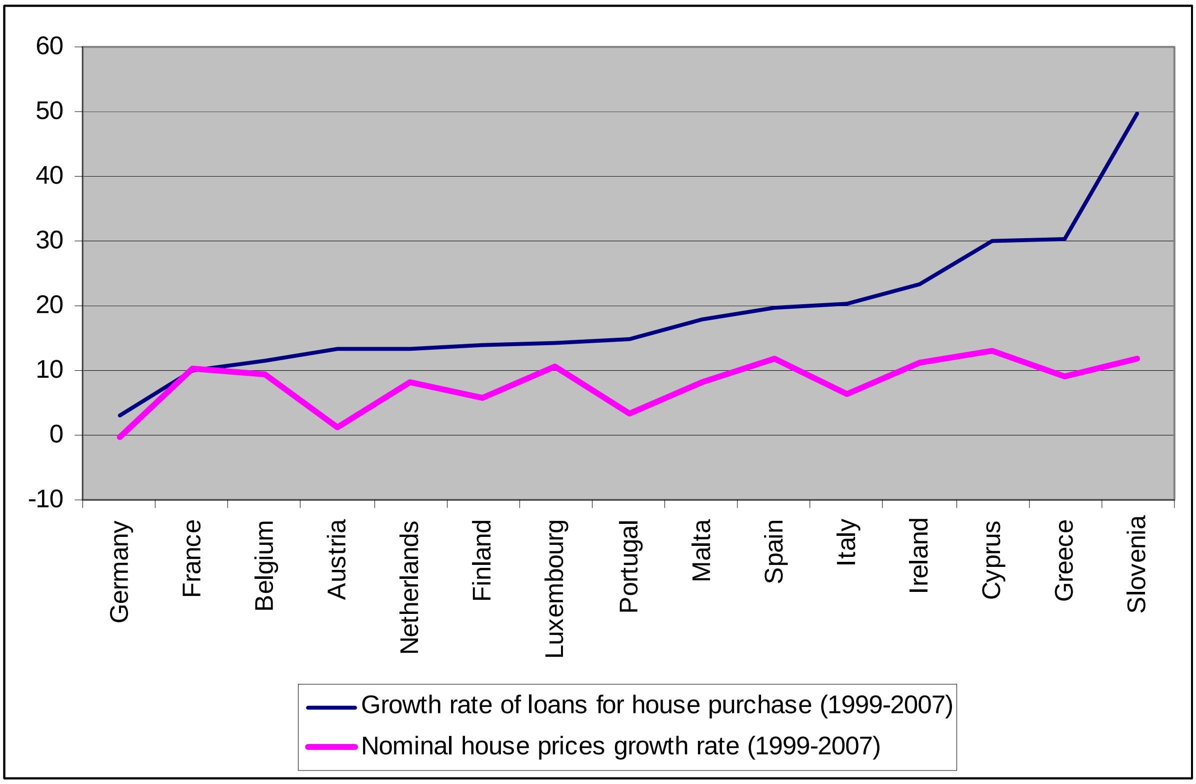


Source: Latest available data from Hypostat 2008: *A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009

The increase in household indebtedness related to loans for house purchase is mirrored in the acquisition of housing wealth by households. As Graph 12 below indicates, the house price growth has been slower than the accumulation of housing debts. This in turn has lead to a rising importance of housing debt for consumers. According to the ECRI statistics, housing loans added up to 72 % of the disposable income of households in the year 2008.[94]

94 See footnote 3.

Graph 12: Growth rate of loans for house purchase versus nominal house price growth (%)



Source: *Monthly Bulletin*, European Central Bank, March 2009

According to a Eurobarometer survey conducted in 2008[95], just over 20 % of those surveyed held a mortgage credit. The large majority were classified as not vulnerable, with only 4.6 % of vulnerable consumers saying that they held a mortgage credit. Most mortgage borrowers were also in some form of employment (20.7 % were manual workers and held a mortgage credit; 34.3 % employees; and 29.6 % self-employed). This data roughly corresponds to ECB statistics[96], which show that within the euro area, 20 % of households have a mortgage, compared to 40 % in the United Kingdom and 45 % in the United States. The United Kingdom and the US also differ somewhat from the euro area with respect to the distribution of mortgages amongst income groups. The share of low income households with mortgages in the US and the United Kingdom is 16 % and 10 % respectively, and the share of the highest income households with mortgages is 76 % and 68 % respectively.[97] This is a marked difference from the euro area where the share ranges from 4 % for the lowest income households to 40 % for the highest.[98]

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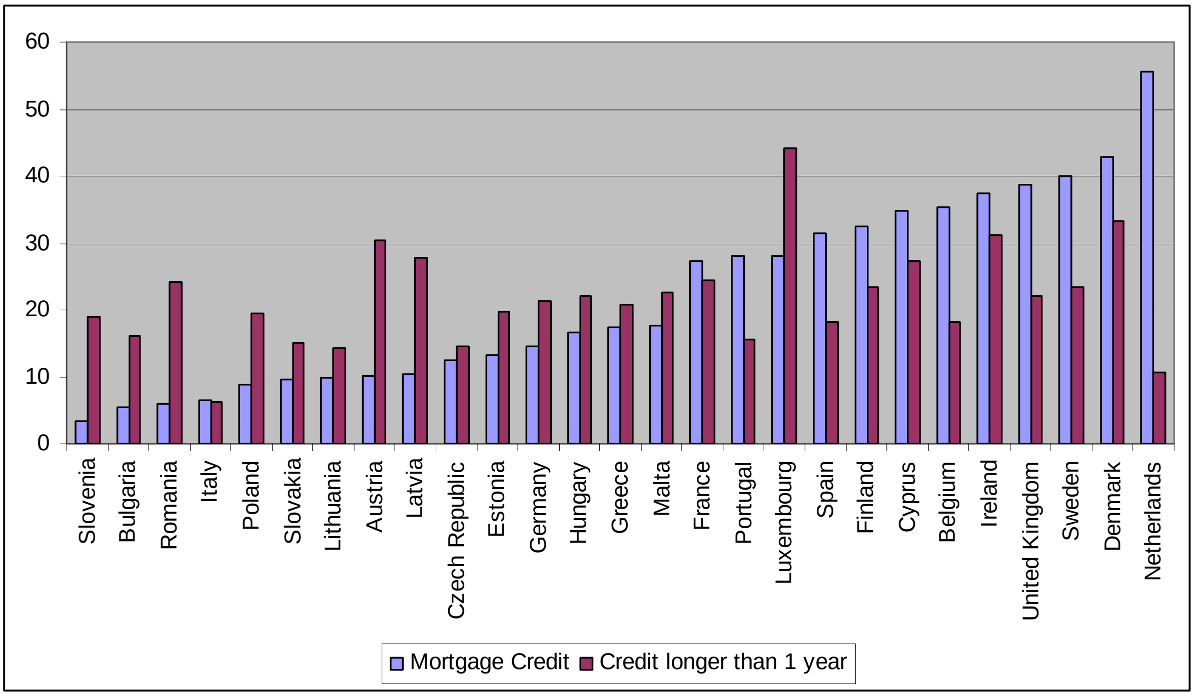
95 *Flash Eurobarometer 243: Consumers' views on switching service providers*, European Commission, 2009.

96 *Monthly Bulletin*, European Central Bank, March 2009.

97 See footnote 96.

98 See footnote 96.

Graph 13: Consumer use of credit (share of households with credit, %)



Source: *Consumers' views on switching service providers*, Eurobarometer, European Commission, January 2009, p. 37 and 52

In the EU27 in 2007, 12 % of consumers spent 40 % or more of their disposable income on housing[99]. However, amongst EU Member States, the situation varies. On the one hand, countries with the lowest share of the population where consumers' housing costs exceeds 40 % of the disposable income were Cyprus (2 %), and Malta and Ireland (both 3 %).[100] On the other hand, the share was around 18–19 % in Romania, the Netherlands and Slovakia.[101] Finally, the highest value was reached in Germany with 23 %.[102]

The proportion of housing costs to disposable income reached 18 % in 2007.[103] The median of the distribution, however, varied largely across Europe and ranged from 6 % up to 27 %.[104] The lowest values were in Malta, Cyprus, Ireland and Luxembourg with 50 % of individuals living in households for which the housing costs represented less than 10 % of the total disposable income.[105] However, 50 % of the population in Romania, the United Kingdom, Greece, Slovakia, Denmark, Germany and the Netherlands lived in households for which the housing costs represented more than 20 % of the total disposable income.[106]

5.1. Overindebtedness

Economic theory and empirical studies suggest that people like to spend in accordance with their expected lifetime income. On aggregate, people do not fully adjust their spending to

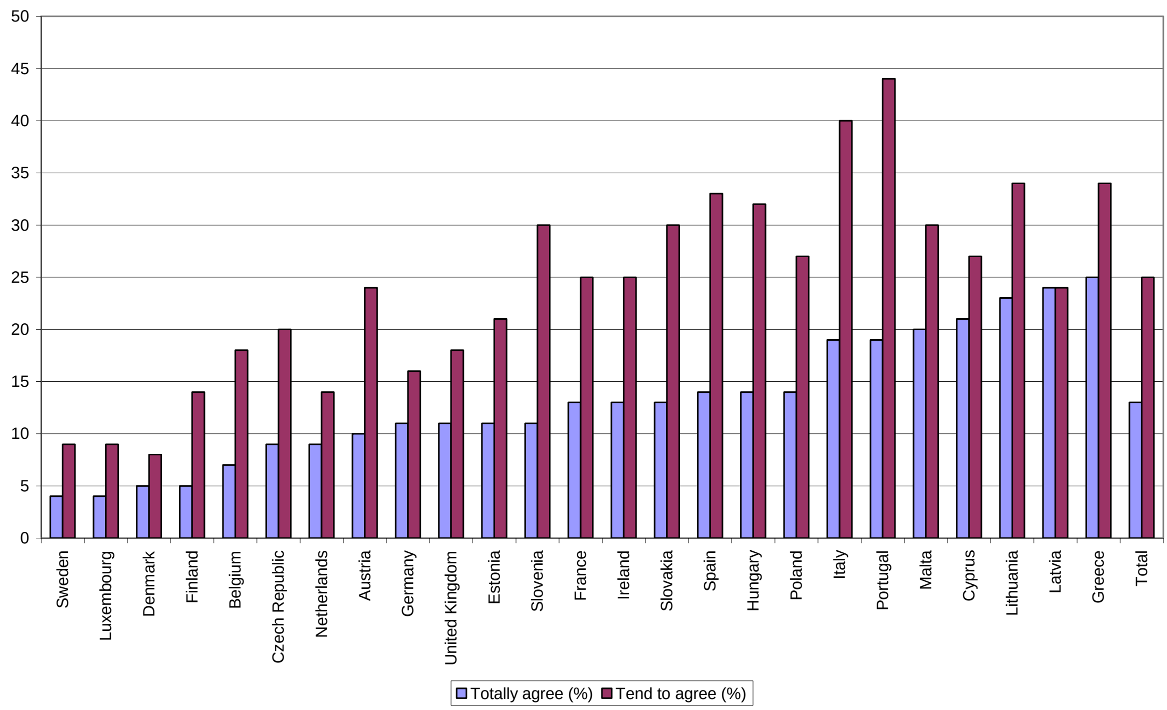
99 See footnote 10.
100 See footnote 10.
101 See footnote 10.
102 See footnote 10.
103 See footnote 10.
104 See footnote 10.
105 See footnote 10.
106 See footnote 10.

changes in their income: they save more when their income is temporarily high and they save less and/or borrow more when their income is temporarily low. There is some controversy as to whether rich and poor people act differently, but there is agreement that consumption smoothing is a goal sought by people.

For consumers to keep their spending unchanged in the face of income changes, the financial system has to function efficiently, especially for liquidity-constrained people. Hence, households taking on debts may not be a problem as long as the levels of debt are sustainable. However, problems for society and the wider economy may arise in the case of overindebtedness. People are considered overindebted if they are having difficulties meeting (or are falling behind with) their household commitments, whether these relate to servicing secured or unsecured borrowing or to payment of rent, utility or other household bills.[107]

In a 2008 Eurobarometer[108], 16 % of people reported difficulties with paying bills, with a further 31 % 'tending to agree' with the statement that there have been difficulties. The magnitude of reported payment difficulties varies widely among Member States. In Denmark on the one hand, only 5 % totally agreed that they have had difficulties paying bills with 10 % tending to agree. In Bulgaria, on the other hand, almost half (45 %) agreed that they had difficult paying bills with a further 31 % tending to agree.[109]

Graph 14: People agreeing with the statement that there have been difficulties in paying bills (%)



Source: Eurobarometer (2006), European Commission (2008)

The EU survey on Income, Social Inclusion and Living Conditions (EU-SILC) asked for information on arrears in the preceding 12 months on mortgage, rent, utility, hire purchase or

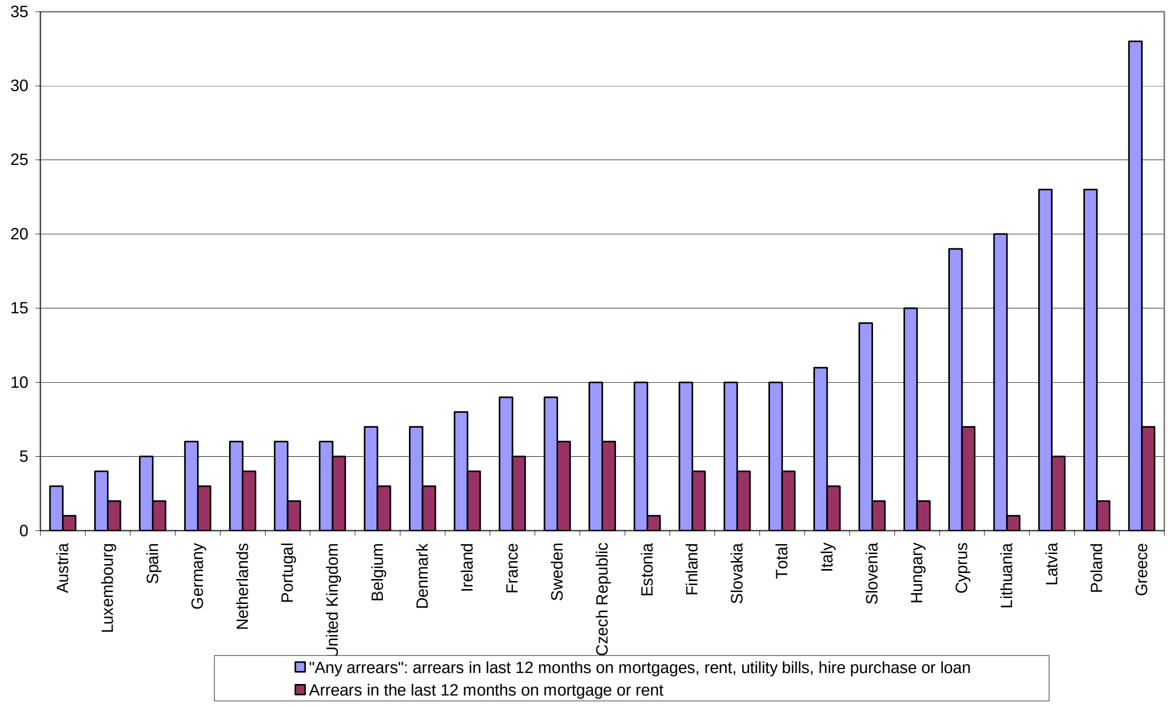
107 See footnote 12.

108 *The European Union Today and Tomorrow*, Eurobarometer 69, November 2008.

109 See footnote 108.

loan bills.[110] It was found that the proportion of people experiencing arrears is lowest in Austria with 3 % and highest in Hungary where one in three persons experience arrears.[111] In total, 10 % of all households interviewed reported arrears of some kind.

Graph 15: Arrears in the last 12 months



Source: *Towards a common operational European Definition of over-indebtedness*, European Commission, 2005 & 2008

According to information provided to the Commission by Member States, there has been an increase in default rates between end of 2007 and end of March 2009. Only one Member State, Belgium, reported a decrease in default rates. Member States experiencing an increase in default rates face increases of varying severity. For instance, while default rates in the Czech Republic, Finland, France, Ireland, Malta, Portugal, Slovakia and Norway rose only slightly, default rates in Denmark more than doubled between end 2007 and March 2009 and more than doubled from mid-2008 to mid-2009 in Lithuania. In Spain, they more than tripled from end 2007 to end 2008. Default rates in Estonia and Romania rose more than fourfold between spring 2008 and spring 2009. Latvia's default rates increased the most: by end March 2009 default rates were ten times the level of end 2007. In contrast, Bulgaria and, to a very marginal extent Poland, have experienced decreases in default rates in 2008 compared to 2007 but an increase in 2009 compared to 2008, which in the case of Bulgaria roughly doubles the 2007 figure.

The observed increases should be looked at carefully when drawing conclusions on the extent of the problem. Apart from Cyprus, Greece, Hungary and Latvia, in none of the Member States and Norway, do loans over 3 months in arrears account for more than 3 % of total outstanding mortgage loans. However such low country-wide figures should not undermine the social and economic impact and importance of arrears for the individual

110 See footnote 12.
111 See footnote 12.

borrowers concerned. With regard to Hungary, it should be noted that the figure includes also consumer loans, for which the default rate might be higher than just for residential loans.[112] Member States therefore seem to experience the impact of the current crisis very differently. This is supported by the fact that the three Member States with the highest increase (Latvia, Lithuania and Romania), exhibit very different default rates: 7.90 % in Latvia; 2.14 % in Lithuania; and 0.14 % in Romania. Clearly, those relative increases must be viewed alongside the absolute default rate, which is low in some of these cases. Increases which are relatively low but which start from a high base are also a cause for concern.

[112] Available statistics for some Member States suggest that the default rate for consumer loans has been higher than for mortgage loans. For instance, while default rates for mortgage loans in Bulgaria amount to 2.55 % at the end of the first half of 2009, default rates for consumer loans in Bulgaria are 11.25 %. For Romania, the default rate for mortgage loans alone was 0.14 % in February 2009, while the default rate for consumer loans (including mortgage loans) was more than 4 % at the same time.

Table 2: Evolution of default rates (percentage of mortgage loans over 90 days in arrears on outstanding mortgage loans) over recent months

	Default rate 31.12.2007 (%)	Default rate 31.12.2008 (%)	Default rate 31.3.2009 (%)	Increase?
Belgium	1.72	1.65		**No**
Bulgaria	1.32	0.53	2.55[7)]	Yes (2009 compared to 2007)
Cyprus	3.24	3.90	4.78	Yes
Czech Republic	1.27	1.53	1.71	Yes
Denmark	0.63	1.18	1.54	Yes
Estonia	0.5[1)]	1.4	2.3	Yes
Finland	0.12	0.17		Yes (NB! Data have been calculated using statistics on number of judgements on payment demands.)
France	0.91	0.93		Yes (NB! Data denote 'taux de créance douteuse' which is broader than default rate, only loans which are 6 months in arrears.)
Greece	3.6	5.3	6.4	Yes
Hungary	2.9	3.6	5.12	Yes (NB! Data include both consumer and mortgage loans.)
Ireland	1.21[8)]	1.44[2)]		Yes
Italy	1.0*	1.4*		Yes (loans)
Latvia	0.71	4.73	7.70	Yes
Lithuania		0.87[2)]	2.14[9)]	Yes
Malta		0.53–0.84		Yes
Norway	0.50	0.7		Yes
Poland	1.2	1.0	1.1 (1.4 for I–III Q 2009)	Yes (2009 compared to 2007)
Portugal	1.3*	1.3[5)] (1.5*)	1.60[4)] (1.7* July 2009)	Yes
Romania		0.03[6)]	0.14[4)]	Yes
Slovakia	2.17	2.27	2.64	Yes
Spain	0.69	2.33	2.88*	Yes
United Kingdom	1.86	2.43	2.60	Yes

Source: Information provided by Member States as of July 2009
* Data has been provided by industry
1) 31.3.2008
2) 30.6.2008/1.7.2008
3) January 2008
4) February 2009
5) February 2008
6) April 2008
7) 30.6.2009
8) 31.12.2006
9) 1.5.2009

Calculation of the average EU default rate

In order to assess the costs and benefits of potential policy options, it is important to know the average EU default rate.

A weighted average has been calculated on the basis of the above data. The data has been weighted on the basis of outstanding residential mortgage loans. This was chosen on the basis that (a) time series data was available from Hypostat published by the European Mortgage Federation and (b) it was a good indicator of the relative size of EU mortgage markets.

The weighted average default rate in 2007 is 1.43 (based on data from 14 Member States).

The weighted average default rate in 2008 is 1.94 (based on data from 19 Member States).

For calculating the benefits of a reduction in the number of defaults, the 2007 figure has been selected. It was felt that this was closer to a 'norm' as the 2008 figure reflects more strongly the results of the financial crisis.

The data provided reveal a mixed picture in the Member States. While five Member States have not experienced a noticeable increase or have even experienced a decrease in the number of foreclosure procedures, the majority of Member States who provided information (ten Member States) have noted an increase in the opening of foreclosure procedures. However, considerable differences exist. For instance, while Austria, Cyprus, and Ireland have experienced a rather modest increase in the number of foreclosure procedures opened, Finland, Sweden, Slovakia, United Kingdom and, in particular, Spain, Bulgaria and Denmark, have seen high increases in recent months.

Again, the rising numbers need to be interpreted with caution for two reasons. First, while, for instance, an increase of more than 63 % in Finland seems high, the total number of foreclosure procedures is still below 1 000 and includes more than residential mortgage loans. At least some Member States have therefore started their increase from a very low base. Second, the total volume of foreclosure procedures and their increase should be looked at in relation to the total number of outstanding residential mortgage loans. This would provide an idea about the extent of the problem in a market. For instance, while the sheer number of 46 825 foreclosures in 2008 in the United Kingdom seems to be very high, compared to the total number of outstanding mortgages, the number of foreclosures is still relatively low (0.30 %).[113]

[113] Data has been provided by the UK Financial Service Authority in reply to the Commission's questionnaire.

Table 3: Evolution of the number of foreclosure procedures over the recent months

	Number of foreclosures in 2007[1)]	Number of foreclosures in 2008[1)]	Number of foreclosures in Q1 2009[1)]	% change 2007-2008	Increase?
Austria	7 908	8 186		3.52	Yes
Bulgaria	449 (45[2)])	886 (98[2)])	1 570[3)] (67[2)3)])	97.33	Yes
Cyprus	596 (27[2)])	636 (14[2)])	207[4)] (9[2)4)])	6.71	Yes
Denmark	1 015	1 942	563	91.33	Yes
Finland	506	825		63.04	Yes (NB! Data also include other loans than residential mortgages and also include legal persons.)
France					Not aware of any noticeable increase in foreclosure procedures.
Germany	91 603	88 379	44 719[5)]	-3.52	**No**
Ireland		96[2)]			Only slight increase from a very small base.
Malta					Not aware of any noticeable increase in foreclosure procedures.
Netherlands	1 800	1 800		0	**No**
Poland	1 841	1 618		-12.11	**No**
Slovakia	1 070	1 865		74.30	Yes (NB! Data reflect all foreclosures of which residential mortgage loans account for approximately 90 %.)
Spain	25 943 (17 402[2)])	58 686 (20 549[2)])	23 433*	126.21	Yes (NB! Data apply to all mortgages, not only for housing.)
Sweden	1 904	3 157		65.81	Yes
United Kingdom	27 921[2)]	46 825[2)] (0.30 % of all mortgages)	14 825[2)]	67.74	Yes

Source: Information provided by Member States as of July 2009
[1)] Data refers to opening of foreclosure procedures which does not necessarily correspond to the number of concluded foreclosure procedures in a given year unless indicated differently.
[2)] Data refers to forced sales. In Spain, this figure refers to the concluded foreclosure procedure, i.e. resolved by the judge whether in favour of the lender or not.
[3)] 30.6.2009
[4)] 30.4.2009
[5)] 30.6.2009

6. CUSTOMER MOBILITY

Customer mobility can be assessed in terms of how easy it is for consumers to switch from one provider to another. Patterns of switching behaviour provide an important indicator that the demand side of a market is well-developed and that consumers are sufficiently empowered to participate actively. The motivation to switch is generally a function of consumers' assessment of the benefits derived from their existing choice of product or performance of their existing supplier; and whether or not they believe there are better alternative products and suppliers available.[114]

The ability and willingness of consumers to switch is critically important for efficient markets and to reduce risks of consumer detriment. If switching is discouraged or impeded this could

114 *Final Report – Establishment of a Benchmark on the Economic Impact of the Consumer Credit Directive on the Functioning of the Internal Market in this Sector and on the Level of Consumer Protection*, GHK Consulting, 2009.

impact not only on the demand side but also potentially raise supply side barriers. This is because new entrants could be deterred from entering the market in the belief that it will be difficult to persuade consumers to switch from their existing provider. This could diminish the effectiveness of competition and serve to limit the benefits that consumers would otherwise derive from switching[115].

However, switching data must be analysed with care and alongside other factors influencing the market. There is no optimal level of switching and consumers do not automatically benefit as a result of switching[116]. High switching levels do not automatically signify that a market is competitive. Consumers who have not switched will not necessarily be worse off. The incumbent provider may happen to offer the best deal for their particular circumstances.[117]

In general, evidence gathered in surveys suggests that consumer mobility is rather low in respect of mortgage credit compared to other services such as broadband or mobile phones: with 13 % of respondents having switched mortgage product and/or providers and 10 % of respondents switching a long-term consumer credit (credit with a duration of more than 1 year that is not a mortgage credit)[118] in the past two years; mortgages have been in equal fifth place (with investment/savings products) in the Eurobarometer ranking of most frequently switched services in Europe.[119] In the EU, 14 % of those with a mortgage have attempted to switch providers in the past two years, 13 % of the interviewed consumers did switch over to another provider and 2 % gave up before the move was complete.[120] Most of those who managed to switch providers or products (11 % of all consumers interviewed) found the process to be easy while 3 % reported that this it was rather difficult.[121]

The perceived difficulty of switching contracts varies among Member States. Consumers in the United Kingdom consider mortgage switching to be easiest with a total of 28 % of consumers switching, with the majority, 24 %, finding the process easy.[122] The proportion of mortgage switchers was also relatively high in the Czech Republic (23 %), Cyprus (14 %), Ireland, (13 %), Finland and Austria (both 12 %).[123] The least numbers of users who switched providers were seen in Lithuania and Bulgaria (both 1 %), Slovakia and Latvia (both 3 %).[124] In fact, in Bulgaria and Latvia, those who tried to switch but gave up marginally outnumbered those who actually succeeded.[125] Consumers found switching long term consumer credit

115 The National Consumer Council in its research titled *Switched on to switching? A survey of consumer behaviour and attitudes, 2000–2005*, states that "when markets function properly, consumers can identify which product is best for them and switch if they want to get a better deal. This, in turn, encourages companies to compete vigorously to retain current customers and attract new ones. It ensures that companies cut costs and innovate in order to offer products that meet consumers' needs at low prices."

116 See *Irrationality in consumers' switching decisions: when more firms may mean less benefit*, CCP Working Paper CCR 05-4, Wilson, C. and Waddams Price, C., 2005, Centre for Competition and Regulation and School of Management, University of East Anglia.

117 See footnote 114.

118 See footnote 95.

119 See footnote 95.

120 See footnote 95.

121 See footnote 95.

122 See footnote 95.

123 See footnote 95.

124 See footnote 95.

125 See footnote 95.

easiest in Greece (21 %), the Netherlands (15 %), Czech Republic (13 %) and Poland (10 %), with the fewest switchers in Slovakia (3 %), Hungary and Luxembourg (both 4 %).[126]

Most users who did not try to switch providers said this was because they had no interest in making such a change: about two thirds (65 % for mortgage credit and 70 % for long term consumer credit) indicated this at the EU27 level.[127] The anticipated difficulties around provider switching prevented only 4 % of all users from trying to switch providers, and 13 % had other reasons for not replacing their service provider.[128] The anticipated difficulties prevented 17 % of respondents in Hungary and Italy from attempting to replace their mortgage contract with a new one[129].

7. PRODUCT DIVERSITY

Households' access to housing-related financing depends on certain key institutional features of the mortgage markets. Significant cross-country differences in mortgage contracts still exist and bring about differences in the access to mortgages across Member States.

The range of products available to consumers in EU mortgage markets may be considered in two ways:

– The availability of products with different characteristics, for example, interest rate structures (variable, fixed, etc.), repayment structures (whether early repayment is available and under what conditions), etc.

– The availability of products for all kinds of borrowers, including the so-called 'non-conforming' or 'sub-prime borrowers' which are generally defined as borrowers who may face difficulties in obtaining credit from mainstream mortgage lenders[130], for example, because they have an insufficient credit history, cannot prove their income (e.g. self-employed), fall out with a range of certain income to value or loan to value (LTV) ratios, or individuals buying to let property.

A wide range of products is currently available for borrowers in the EU. However, no single country could be seen to have a complete range of products available either in terms of product characteristics or borrowers served[131]. Studies estimate that a large 'latent demand' for mortgage borrowing exists in several EU countries, which could potentially be filled by the availability of a wider range of products[132].

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126 See footnote 95.
127 See footnote 95.
128 See footnote 95.
129 See footnote 95.
130 See for example, Financial Services Authority http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/practice/sub_prime.shtml.
131 See Annex 2 for further information.
132 See footnote 14 and *Risk and Funding in European Residential Mortgages*, Mercer Oliver Wyman and the Mortgage Insurance Trade Association, April 2005, Chapter 4, which estimates a maximum demand potential of EUR 1 600 billion for 12 Member States.

Table 4: Product availability for non-conforming borrowers, by borrower type

	Aged 50+	Low equity (LTV > 90)	Previously bankrupt	Self-certified income	Credit impaired	Self-employed
Austria	Good/Limited	Good/Limited	Limited/ Not available	Limited	Limited/ Not available	Limited
Belgium	Good	Good	Limited	Good	Limited	Limited
Czech Republic	Good	Good	Limited	Not available	Limited	Good
Denmark	Good	Good	Not available	Good	Good	Good
Estonia	Good	Limited	Limited	Good	Limited	Good
Finland	Good	Good	Limited	Good	Limited	Good
France	Good	Good	Limited	Limited	Not available	Good
Germany	Good	Good	Limited	Limited	Not available	Good
Greece	Good	Limited	Not available	Limited	Not available	Good
Hungary	Limited	Limited	Not available	Good	Good	Good
Ireland	Good	Good	Limited	Limited	Limited	Good
Italy	Good	Limited	Limited	Limited	Limited	Good
Latvia	Limited	Limited	Limited	Good	Limited	Good
Lithuania	Good	Good	Limited	Limited	Limited	Good
Luxembourg	Limited	Limited	Limited	Good	Limited	Good
Malta	Good	Good	Limited	Good	Limited	Good
Netherlands	Good	Good	Limited	Good	Limited	Good
Poland	Good	Good	Good	Not available	Not available	Limited
Portugal	Good	Good	Not available	Limited	Limited	Good
Slovakia	Limited	Good	Limited	Limited	Not available	Good
Slovenia	Good	Limited	Not available	Limited	Limited	Limited
Spain	Good	Good	Limited	Limited	Limited	Good
Sweden	Good	Good	Limited	Good	Limited	Good
United Kingdom	Good	Good	Limited	Good	Good	Good

Source: *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 138. For the Netherlands and Poland: *Risk and Funding in European Residential Mortgages*, Mercer Oliver Wyman and the Mortgage Insurance Trade Association, April 2005. Data is missing for Bulgaria, Cyprus and Romania.

According to an index developed by the IMF[133] to capture such cross-border differences, Denmark, Sweden and the Netherlands appear to have the most flexible and 'complete' mortgage markets among the EU Member States. Other Member States such as Germany, France and Italy achieve much lower scores which suggests that mortgage markets in these countries provide more limited access to finance.[134]

The range of products available for consumers is however also closely related to the wider state of the economy. In the midst of the financial crisis, higher equity mortgages (e.g. loans with higher loan-to-value ratios) and some forms of interest rate contracts became difficult to impossible to obtain. For example, in February 2009 in the United Kingdom there were 1 542 different home loans available compared with 15 599 in July 2007: only three products were available for a deposit of 5 % (compared to 1 079 in July 2007) and 113 required 10 % deposit; no variable-rate self-certification deals were available; the maximum loan to value ratios lenders would advance on fixed-rate products was 75 %.[135] The financial crisis has

[133] *The changing housing cycle and the implications monetary policy*, World Economic Outlook, IMF, April 2008, Chapter 3, http://www.imf.org/external/pubs/ft/weo/2008/01/pdf/c3.pdf.

[134] See footnote 133.

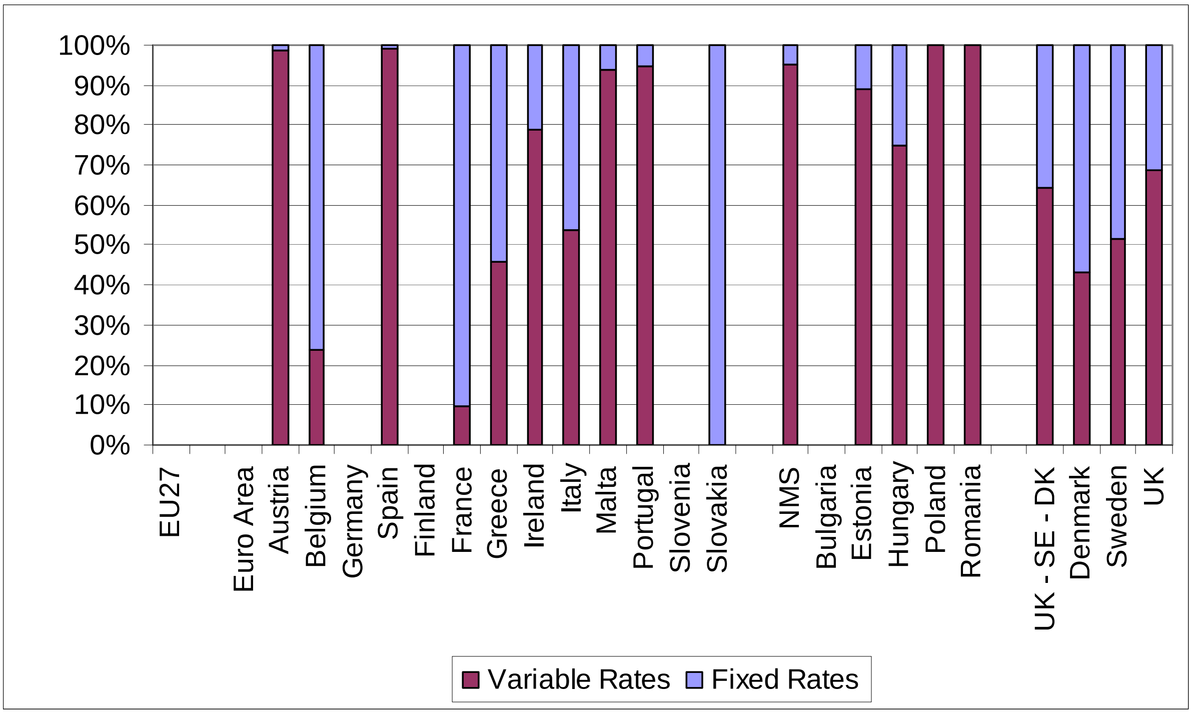
[135] *Slump in number of mortgage products on offer*, The Independent, 9.2.2009. Based on data from Moneyfacts.co.uk.

therefore brought about changes in the availability of mortgage products in a number of Member States, however according to recent research, "it is impossible to determine to what extent this is just a temporary phenomenon or a major structural change in the market place".[136]

7.1. Interest rates

The euro area has a preference for fixed interest rate loans. At the end of 2008, 65.8 % of outstanding mortgage loans in the euro area were fixed rate loans, compared to 54.2 % for the EU as a whole[137]. Variable rate loans accounted for a large proportion of outstanding credits in countries such as Austria, Spain, Finland, Ireland, Malta, Portugal, Estonia, Hungary, Poland, and United Kingdom[138]. New loans issued in Q4 2008 in these countries were also predominantly variable.[139]

Graph 16: Outstanding credits for house purchasing by interest rate type 2009 Q1



Source: ECFIN Retail Banking Survey 2009 Q1

7.2. Duration

In terms of the duration of mortgage credits, the average length across the EU is relatively homogenous: the average maturity of new mortgage credits in the EU at the end of 2008 was

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136 *Study on the costs and benefits of different policy options for mortgage credit*, London Economics with Achim Dübel (Finpolconsult) in association with the institute für finanzdienstleistungen (iff), November 2009.

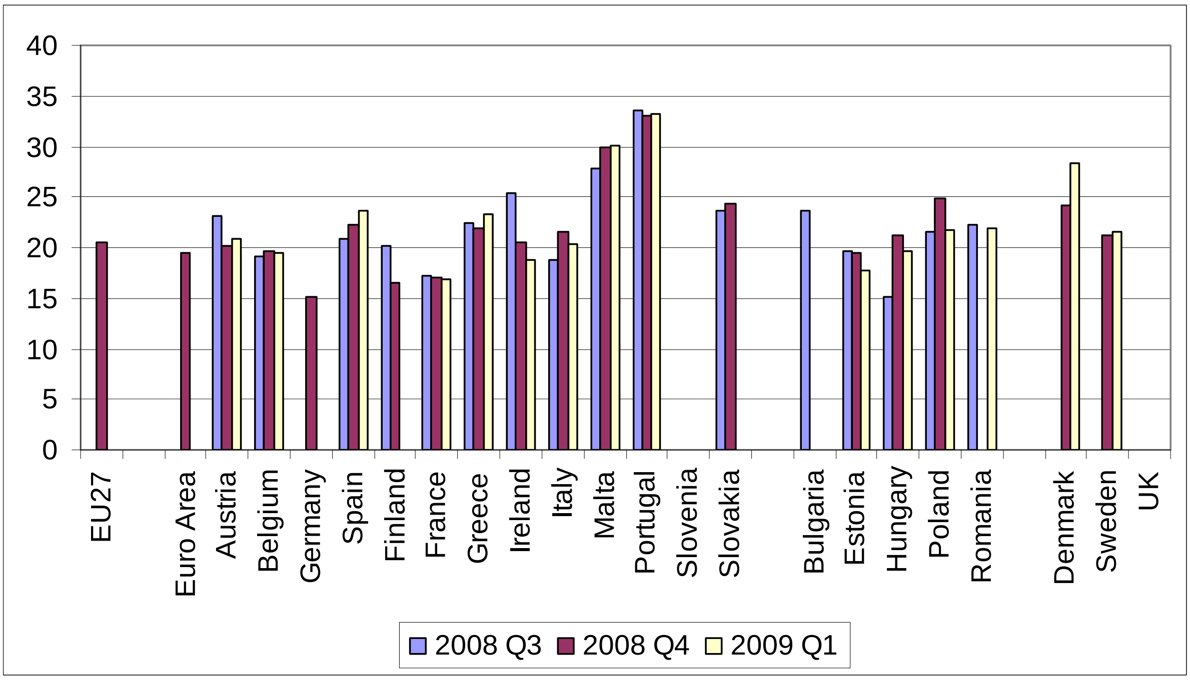
137 *ECFIN Retail Banking Survey*, 2009 Q1.

138 See footnote 137.

139 See footnote 137.

20.5 years.[140] The duration ranged from 15.1 years in Germany and 16.5 years in Finland to 29.9 years in Malta and 33 years in Portugal.[141]

Graph 17: New credits for house purchasing – Average maturity in years



Source: ECFIN Retail Banking Survey 2009 Q1

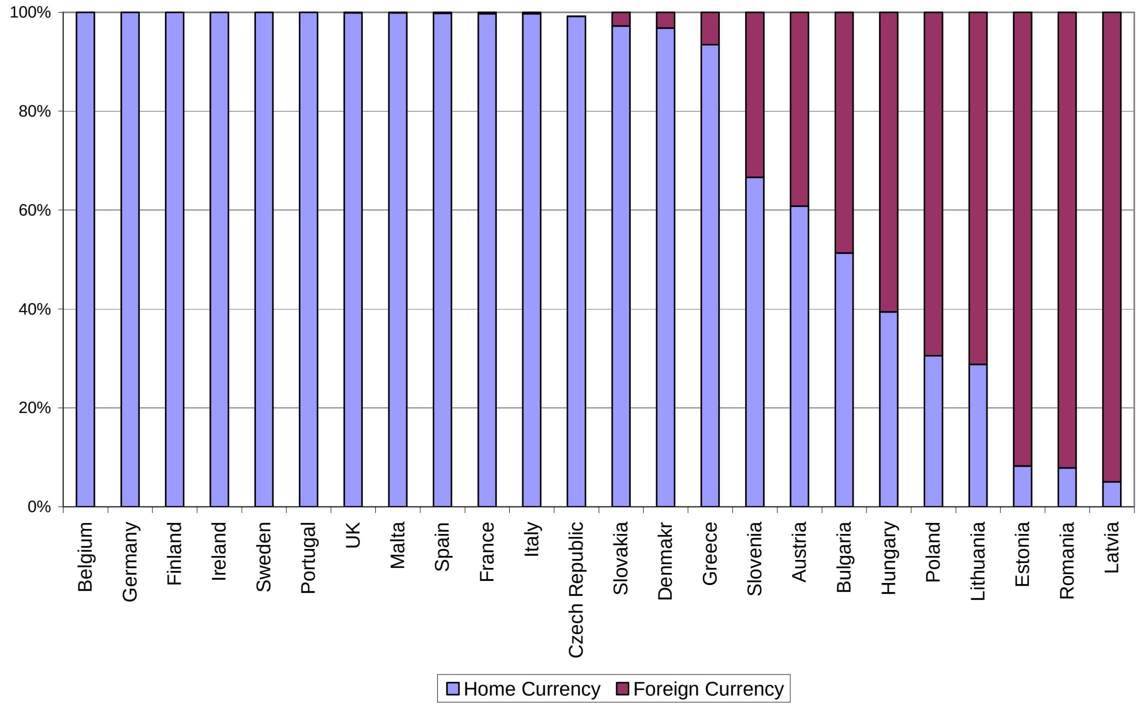
7.3. Mortgages by currency

The financial turmoil has drawn considerable attention to problems that may arise from mortgages taken out in foreign currency. Such mortgages may give rise to macroeconomic issues and aggravate financial stability problems. The vast majority of mortgages issued in the EU are in domestic currencies. In the euro area, 97.6 % of outstanding mortgage loans were in domestic currencies as of Q1 2009.[142]

As Graph 18 indicates, mortgages in foreign currency are prevalent in new Member States that are not members of the euro area. In Latvia, Romania and Estonia, the proportion of these mortgages is highest with more than 90 %. Within the euro area, Austria is the only Member State with a significant share of foreign currency mortgages. At the end of 2008, more than 38 % of Austria's outstanding mortgage credit was denominated in a foreign currency[143].

140 See footnote 137.
141 See footnote 137.
142 See footnote 137.
143 See footnotes 3 and 137.

Graph 18: Mortgage credit in home and foreign currency, 2008



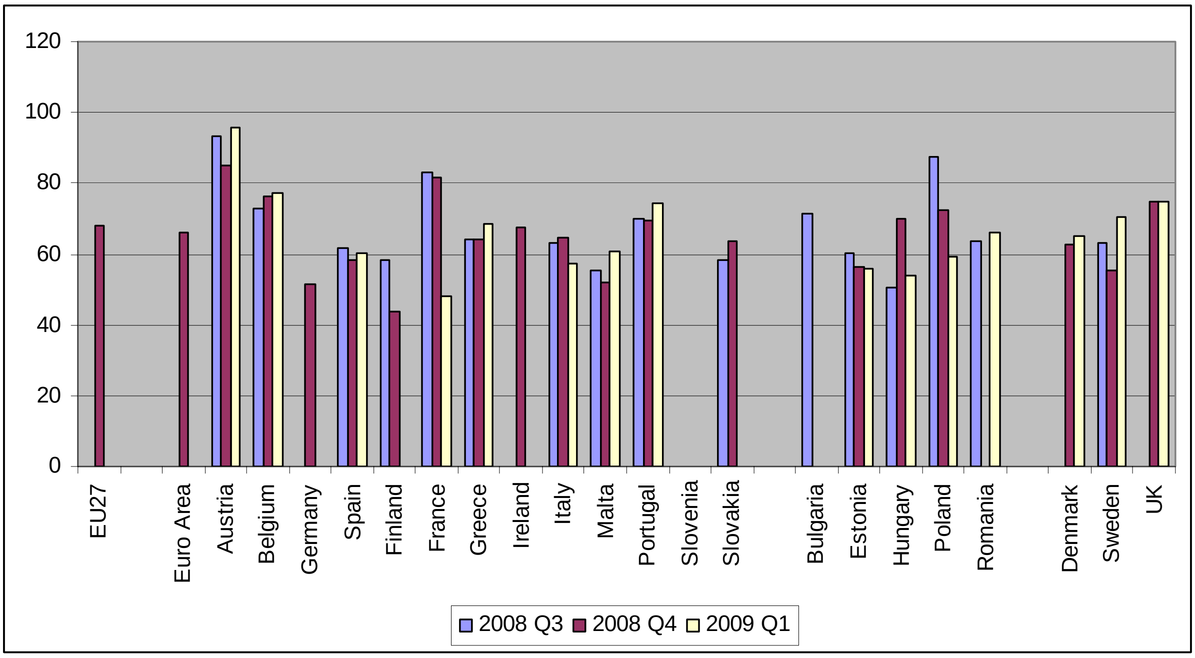
Source: ECRI Statistical Package 2009, ECFIN Retail Banking Survey 2009 Q1

7.4. Loan to value ratios

More interestingly, however, are the loan amounts in relation to the property values. The loan-to-value ratio of new credits was highest in Austria with 95.8 % and lowest in France with 47.9 % in the first quarter of 2009.[144] It needs to be noted however, that the figure for France represents an important drop from the around 80 % levels in both the last two quarters of 2008.

[144] See footnote 137.

Graph 19: New credit for house purchase – Average LTV



Source: ECFIN Retail Banking Survey, 2009 Q1

Typical loan to value ratios for first-time buyers in the euro area range from 63 % in Malta and 65 % in Italy and Slovenia, to 91 % in France and 101 % in the Netherlands.[145]

145 See footnote 136.

ANNEX 2 – Consultative process

1. INTRODUCTION

In line with the Commission's better regulation principle, a thorough analysis has been undertaken of the problems and issues at stake. In this regard, the Commission has followed an open and thorough consultative process. This annex provides an overview of the main steps taken.

Table 1: Chronology of events

Date	
2003	
March	Establishment of Forum Group on Mortgage Credit
2004	
	Establishment of FIN-USE
13 December	Publication of the Forum Group Report on Mortgage Credit
2005	
February	Establishment of the Government Expert Group on Mortgage Credit (GEGMC)
19 July	Publication of the Green Paper on Mortgage Credit in the EU
5 August	Publication of the Study on the Costs and Benefits of Integration of EU Mortgage
7 December	Public Hearing on Mortgage Credit
15 December	European Economic and Social Committee Opinion on the Green Paper on Mortgage Credit in the EU
2006	
	Establishment of Financial Services Consumer Group
	Establishment of the Mortgage Funding Expert Group
	European Parliament Report on Mortgage Credit in the EU
2007	
January	Publication of the Report of the Mortgage Funding Expert Group and public consultation
January	Publication of the Report of the Mortgage Industry and Consumer Dialogue and public consultation
	Establishment of Government Expert Group on Retail Financial Services (GEGRFS)
18 December	Publication of White Paper on the Integration of EU Mortgage Credit Markets
2008	
	Ongoing meetings with stakeholders
May	European Parliament Report on the Green Paper on Retail Financial Services
May	European Parliament Resolution on Competition: Sector Inquiry on Retail Banking
4 September	Establishment of the Expert Group on Credit Histories
19 September	Publication of Study on the role and regulation of non-credit institutions in EU mortgage markets
2009	
	Ongoing meetings with stakeholders
15 January	Publication of the Study on Credit Intermediaries in the Internal Market
3 February	European Economic and Social Committee Report on the White Paper on the integration of EU mortgage markets
25 February	Publication of the High-Level Group on Financial Supervision in the EU Report
4 March	Communication to the Spring European Council Driving European Recovery
18 March	Publication of Study on Equity Release Schemes in the EU
4 May	Stakeholder Workshop Consumer testing of a possible new format and content for the ESIS
15 June–31 August	Responsible Lending and Borrowing Consultation Period
15 June–31 August	Publication of the Report of the Expert Group on Credit Histories and consultation period
3 September	Public Hearing on Responsible Lending and Borrowing
October 2009	Publication of Study on consumer testing of possible new format and content for the European Standardised Information Sheet (ESIS) on home loans
November 2009	Submission of Study on the costs and benefits of different policy options for mortgage credit

2. CONSULTATION OF INTERESTED PARTIES

2.1. Commission reports and consultations

2.1.1. Green Paper on Mortgage Credit in the EU

After reviewing the recommendations of the Forum Group, in July 2005, the European Commission published a *Green Paper on Mortgage Credit in the EU*[146]. The Green Paper examined the case for Commission action, looking at whether and how Commission action to develop the single market in mortgages could enhance efficiency and competitiveness and provide concrete benefits for EU consumers. The publication of the Green Paper launched a public consultation which ended in December 2005 with a public hearing in Brussels[147]. All contributions authorised for publication were published on the internet[148]. A report summarising the feedback received in the Green Paper consultation was published in May 2006[149].

2.1.2. White Paper on the Integration of EU Mortgage Credit Markets

The Commission continued its analysis of the EU mortgage market and on 18 December 2007 published the *White Paper on the Integration of EU Mortgage Credit Markets*[150]. The paper summarises the conclusions of a comprehensive review of European residential mortgage markets and presents a balanced 'package' of measures to improve the efficiency and the competitiveness of these markets, to the benefit of consumers, mortgage lenders and investors alike. The White paper highlights areas of further work in particular improvement in cross-border supply, product diversity, consumer empowerment and customer mobility.

2.1.3. Responsible lending and borrowing consultation

On 15 June 2009, the European Commission published a public consultation document on Responsible Lending and Borrowing in the EU, and invited stakeholders to respond by 31 August 2009.[151] The consultation invited stakeholders' views on issues such as the advertising and marketing of credit products, the pre-contractual information provided, ways to assess product suitability and borrower creditworthiness, advice standards, responsible borrowing and issues relating to the framework for credit intermediaries (e.g. disclosures, registration, authorisation and supervision). In total 109 responses from 19 Member States and 1 EEA country were received from a wide range of stakeholders, such as chambers of commerce, individual citizen, consumer advocates, consumer and user representatives, corporate, credit registers, financial sector trade unions, financial services industry federations, financial services providers, microfinance providers, Member State authorities, non-financial services industry federations and ombudsmen. All contributions authorised for

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146 COM(2005) 327, 19.7.2005.

147 Further information about the hearing is available at http://ec.europa.eu/internal_market/finservicesretail/home-loans/integration_en.htm#greenpaper

148 http://ec.europa.eu/internal_market/finservices-retail/home-loans/comments_en.htm

149 http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/feedback_gp-en.pdf

150 http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm#documents

151 http://ec.europa.eu/internal_market/consultations/2009/responsible_lending_en.htm

publication were published on the internet[152]. A public hearing on responsible lending and borrowing was held in Brussels on 3 September 2009 to discuss with stakeholders the most appropriate policy responses to the challenges faced by borrowers and the financial services industry, and to draw together the main conclusions from the consultation.[153] A report summarising the feedback received in the consultation was published in November 2009[154].

2.1.4. Report of High-Level Group on Financial Supervision in the EU and European Commission Communication to the Spring European Council Driving European Recovery

The High-Level Group chaired by Jacques de Larosière[155] published a report on financial supervision in the EU on 25 February 2009. The report identified the need for a stronger and integrated European system of regulation and set out a framework to develop a European system of financial supervision, which is now being worked out in the legislative proposals to establish the European Supervisory Authorities and European Systemic Risk Board[156]. In line with the findings of the Group of Twenty (G20), the de Larosière report recommended that "appropriate regulation must be extended, in a proportionate manner, to all firms or entities conducting financial activities which may have a systemic impact[157]".

In the Communication to the Spring European Council of 4 March 2009[158], the European Commission undertook to come forward with measures at EU level on responsible lending and borrowing, including a reliable framework on credit intermediation, in the context of delivering responsible and reliable markets for the future and restoring consumer confidence.

2.2. Consultation of Member States

2.2.1. Government Expert Group on Mortgage Credit

The Government Expert Group on Mortgage Credit was established in early 2005 to advise the Commission on its policy on mortgage credit. It is composed of Member State representatives from all EU Member States, plus some EFTA countries. Representatives come from a range of bodies, including Ministries of Finance, Ministries of Justice, financial regulators, etc. Its main tasks are to assist the Commission in the definition and development of its mortgage credit policy. GEGMC has met six times since its establishment in 2005 (24.2.2005, 31.5.2006, 1.10.2007, 13.2.2008, 19.9.2008 and 18.11.2009).

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152 http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/responsible_borrowing&vm=detailed&sb=Title

153 http://ec.europa.eu/internal_market/finservices-retail/docs/credit/resp_lending/summary_en.pdf

154 http://ec.europa.eu/internal_market/finservices-retail/docs/credit/resp_lending/feedback_summary_en.pdf

155 For an overview of all of the legislative proposals, see http://ec.europa.eu/internal_market/finances/committees/index_en.htm#package.

156 See footnote 155.

157 Page 23 of the report clarifies that such institutions could encompass 'mortgage brokers in some jurisdictions'.

158 COM(2009) 114, http://ec.europa.eu/commission_barroso/president/index_en.htm.

2.2.2. *Government Expert Group on Retail Financial Services*

The Government Expert Group on Retail Financial Services (GEGRFS) was established in 2007, it comprises Member State government experts and its role is to assist the Commission in the development of its policy on retail financial services, including cross-sectoral issues such as credit registers and credit intermediaries. GEGRFS has discussed issues relating to responsible lending and borrowing on several occasions since its establishment: 15 June 2007 (discussion on credit histories); 17 June 2008 (discussion on credit histories and mortgage credit), 26 June 2009 (discussion on responsible lending and borrowing and ESIS testing); and 18 November 2009 (discussion on responsible lending and borrowing).

2.3. Consultation of consumers and users

2.3.1. *FIN-USE*

FIN-USE was established in April 2004 as an expert forum to assist in improving policy-making in the field of financial services by including a user perspective. Since its establishment, FIN-USE has been closely associated in the development of the Commission's financial services policy, discussing mortgage credit and responsible lending on numerous occasions. At its meeting of 17 June 2009, the Commission presented the responsible lending and borrowing initiative and FIN-USE took this opportunity to participate in the consultation and responded in August 2009.[159] FIN-USE has also produced papers on mortgage credit[160].

2.3.2. *Financial Services Consumer Group*

The Financial Services Consumer Group has also been associated to the Commission's work on mortgage credit since its establishment in mid-2006. At its meeting of 20 June 2006, the Commission presented the results of the Green Paper consultation and outlined next steps. In their meeting of September 2009, they discussed responsible lending and borrowing.

2.3.3. *Trade unions*

Consultative meetings were held with UNI-Europa in May and November 2009.

2.4. Feedback from EU institutions

2.4.1. *European Parliament*

The European Parliament has issued three main documents touching on issues relating to responsible lending and borrowing: a Report on Mortgage Credit in the EU[161],a Report on the Green Paper on Retail Financial Services[162], and a Resolution on Competition: Sector Inquiry on Retail Banking[163]

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159 http://ec.europa.eu/internal_market/fin-use_forum/docs/resp_lending_borrowing_en.pdf

160 *Reforming the Mortgage and Credit Markets – An Opinion*, December 2008.
Opinion on the Forum Group on Mortgage Credit Report The Integration of the EU Mortgage Credit Markets, 18.4.2005.
Opinion on the European Commission Green Paper Mortgage Credit in the EU, 30.11.2005.
Papers are available at: http://ec.europa.eu/internal_market/fin-use_forum/documents/index_en.htm.

161 *Report on Mortgage Credit in the EU*, A6-0370/2006.

162 *Report on the Green Paper on Retail Financial Services*, 15.5.2008, A6-0187/2008.

163 *Resolution on Competition: Sector Inquiry on Retail Banking*, P6_TA(2008)0260.

The European Parliament has emphasised that rules should be laid down on the training of credit intermediaries, advertising, and sales consultancy[164]. It expressed its belief that the Code of Conduct and the ESIS are insufficient and encouraged making the former mandatory. On the APRC it stated that its definition and scope should comprise only the cost borne by the lender[165]. Concerning suitability and creditworthiness, the Parliament urged the Commission to facilitate cross-border access to client credit databases on a non-discriminatory basis, pointing out that access to both positive and negative data is desirable[166]; it requested moreover that the Commission make proposals for the interoperability of data registers, while respecting rights to privacy. With respect to credit intermediaries, it urged the Commission to consult on an appropriate regulatory environment for such operators and prepare a proposal. It requested the Commission to clarify and harmonise the responsibilities of credit intermediaries following the principle of 'same business, same risks, same rules' and avoid a 'one-size-fits-all' approach[167]. Finally, on non-credit institutions (NCIs), the Parliament favoured opening up the mortgage credit market to NCIs, on the condition of an equivalent supervisory regime and urged the Commission to clarify the legal status and supervisory framework of non-banking consumer credit providers[168].

2.4.2. European Economic and Social Committee

The Economic and Social Committee (EESC) has also issued several reports on mortgage credit.[169]

The Economic and Social Committee (EESC) supported retaining the Code of Conduct in a voluntary form but at the same time encouraged the introduction of sanction/control/monitoring mechanisms. It also added that the provision of pre-contractual information should apply to credit intermediaries[170], and that incentives should be created to encourage adherence to the voluntary Code of Conduct[171]. On the APRC, the Committee favoured a harmonised common calculation method and cost elements. Concerning mortgage advice, the EESC believed that it should remain optional and that independent pricing mechanisms should be introduced to improve quality[172]. Access to databases cross-border on a non-discriminatory basis was another issue that the Committee expressed its support for. Finally, on NCIs, the EESC stated that NCIs must be subject to prudential controls and that a level playing field should be maintained and the rules applicable to credit institutions must also apply to any of the other institutions[173].

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164 See footnote 162.

165 See footnote 161.

166 See footnote 161.

167 See footnote 163.

168 See footnote 161.

169 *Report on the Green Paper on Mortgage Credit in the EU*, CESE 1503/2005*; Report on the White Paper on the integration of EU Mortgage Credit Markets*, OJ C 27, 3.2.2009.

170 *Report on the Green Paper on Mortgage Credit in the EU*, CESE 1503/2005.

171 *Report on the White Paper on the integration of EU Mortgage Credit Markets*, OJ C 27, 3.2.2009.

172 See footnote 171.

173 See footnote 171.

3. EXPERT GROUPS

3.1. Forum Group on Mortgage Credit

The Forum Group on Mortgage Credit was established in March 2003 and tasked with identifying the main barriers to the development of an integrated market for mortgage credit. The Forum included 20 experts from a wide variety of market participants and stakeholders, including the banking sector, consumer organisation, insurers, chartered surveyors and civil law notaries, from 11 EU national markets. The Forum Group met 14 times from 27 March 2004 to 16 November 2004.

The Report of the Forum Group on The Integration of the EU Mortgage Credit Markets was published in December 2004 and proposed both legislative and non-legislative measures in 48 recommendations to stimulate integration in EU mortgage markets.[174] The recommendations covered five main issues: consumer confidence (e.g. information requirements, early repayment, advice, redress, APRC and interest rate restrictions); legal issues (e.g. applicable law, credit registers, property valuation, and forced sales procedures); collateral issues (e.g. land registration and Euromortgage); distribution issues (e.g. cross-border establishment and credit intermediaries); mortgage finance (e.g. securitisation vehicles, segregation of assets and pooling of assets).

3.2. Mortgage Funding Expert Group (MFEG)

The Mortgage Funding Expert Group[175] was established in April 2006 to identify the barriers to integration for each of the funding models outlined in the Forum Group report, prioritise the barriers identified, and consider possible solutions. Experts were selected to ensure a balance between the different stakeholders involved in the funding process including originators, investors, ratings agencies and investment banks. Experts represented all funding techniques (covered bonds, mortgage-backed securities, deposits, etc.) and most EU mortgage markets. The Mortgage Funding Expert Group met eight times during 2006. The Report of the Mortgage Funding Expert Group was published in December 2006 and opened for consultation in January 2007.[176] All responses to the consultation authorised for publication were published on the internet.[177] A report summarising the feedback received in the consultation was also published on 26 November 2007.[178]

3.3. Mortgage Industry and Consumer Expert Group (MICEG or the so-called Mortgage Dialogue)

The Forum Group report highlighted not only the differing views of industry and consumers but also areas where agreement may be possible. Against this background, in April 2006, Internal Market and Services DG and DG Health and Consumers launched the Mortgage

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174 The full report is available at: http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/2004-report-integration_en.pdf.

175 Further information on the Mortgage Funding Expert Group available at: http://ec.europa.eu/internal_market/finservices-retail/home-loans/integration_en.htm#greenpaper.

176 The report of the Mortgage Funding Expert Group available at: http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/mfeg/final_report-en.pdf.

177 http://ec.europa.eu/internal_market/finservices-retail/home-loans/mortgage_comments_en.htm

178 *Feedback on comments received on reports of the Mortgage Funding Expert Group and Mortgage Industry and Consumer Dialogue*, 26.11.2007, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/feedback_summary-mfeg_miceg_en.pdf.

Dialogue[179] to explore to what extent common principles on four key consumer protection issues, namely: information, advice, early repayment and annual percentage rate (APR), could be agreed upon. Industry was represented by the European Banking Industry Committee (EBIC) and consumers were represented by the European Consumers' Organisation (BEUC), European Community of Consumer Cooperatives (Euro Coop) and Confédération des Organisations Familiales de la Communauté Européenne (COFACE). The Mortgage Dialogue met eight times during 2006.

The Report of the Mortgage Industry and Consumer Expert Group was published in January 2007 and opened for consultation.[180] The Dialogue proved an invaluable source of information for Commission services and for the parties themselves, enabling a full understanding of the positions of consumers and of the mortgage lending industry. However, although a consensus began to emerge on some issues (e.g. the timing for the provision of general pre-contractual information, the need for updating the content of the European Standardised Information Sheet), the discussions have not led to definitive conclusions on how consumer protection could be enhanced. All responses to the consultation authorised for publication were published on the internet.[181] A report summarising the feedback received in the consultation was also published on 26 November 2007.[182]

3.4. Expert Group on Credit Histories (EGCH)

As announced in the Single Market Review[183] and the White Paper on Mortgage Credit, in September 2008, the Expert Group on Credit Histories was established by the European Commission to identify solutions that optimise the circulation of consumers' credit data within the EU, whilst ensuring a high level of consumer protection. It was composed of representatives from all relevant stakeholders: consumers, lenders, credit registers, central banks and data protection authorities. The Expert Group met on 8 occasions in 2008/2009.

The Report of the Expert Group on Credit Histories was published in June 2009 and opened for consultation.[184] All experts took part in the discussions, the formulation of the recommendations and the drafting of the report. The three consumer representatives in the group decided however not to endorse the report for reasons related notably to consumer data protection concerns. The Report calls for action in a number of areas in order to improve the access to and the quality of credit data. The report explains that credit data sharing between creditors is considered an essential element of the financial infrastructure that facilitates access to finance for consumers. The use of credit data in assessing borrowers' creditworthiness is key in order to enhance the quality of creditors' loans portfolio and thus reduce risks. It also assists creditors in complying with responsible lending obligations. Differences in national credit reporting systems can however hinder cross-border lending. Different data content, definitions and registration criteria may render creditors' interpretation of foreign credit reports difficult and their information non-exploitable when assessing a

179 Further information on the Mortgage Industry and Consumer Expert Group available at: http://ec.europa.eu/internal_market/finservices-retail/home-loans/integration_en.htm#greenpaper.

180 Further information on the Mortgage Industry and Consumer Dialogue, including its report, available at: http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/miceg/final_report-en.pdf.

181 http://ec.europa.eu/internal_market/finservices-retail/home-loans/mortgage_comments_en.htm

182 See footnote 180.

183 http://ec.europa.eu/citizens_agenda/docs/sec_2007_1520_en.pdf

184 Further information on the Expert Group on Credit Histories, including its report, available at: http://ec.europa.eu/internal_market/finservices-retail/credit/history_en.htm.

credit request. The report recognises the low appetite for and the high cost involved in radically changing national credit register systems. Thus, experts have rejected global and complex solutions such as setting up a pan-European credit register or aligning all Member States to a single (already existing or new) credit data model. According to the experts, data access model choices should be market driven. Before being implemented, any solutions will need to be carefully evaluated in terms of their costs and benefits for both consumers and creditors. A report summarising the feedback received in the consultation was also published on 30 November 2009.[185]

4. STUDIES

4.1. Study on the costs and benefits of different policy options for mortgage credit

Building on the work already undertaken by the Commission, the study examined the costs and benefits of the different policy options for the following issues: pre-contractual information, Annual Percentage Rate of Charge (APRC), early repayment, and responsible lending. The study assesses the costs and benefits to different stakeholder groups, including consumers, mortgage lenders, credit intermediaries (where relevant), Member States, and any other relevant stakeholder group identified in the impact assessment accompanying the White Paper on the integration of EU mortgage credit markets.

In respect of pre-contractual information, the quantitative analysis reported shows that overall the proposed policy of either a continuation of the voluntary approach with strengthened monitoring and enforcement mechanisms or a legal requirement to provide a revamped, more informative and simplified ESIS would have beneficial effects for consumers across the EU. The analysis also shows that increased provision of an ESIS strengthens consumer confidence in mortgage markets, encourages customer mobility and cross-border lending.

The analysis suggests that the adoption of a common APRC will benefit consumers while imposing some costs on lenders. The benefits, and the costs, grow with the broadness of the APRC and the aggregate combined impact on consumers and lenders cannot be predicted a priori as it depends on a wide range of factors. The implementation of an APRC is also likely to boost consumer confidence in mortgage products and stimulate consumer mobility. Moreover, the broader the APRC, the larger the likely impact on confidence and mobility. However, the impact on product choice and market development is likely to be small or nil. In contrast, cross-border mortgage lending may grow somewhat as a result of the adoption of a harmonised APRC.

For the early repayment policy options, the study concludes that the option at zero compensation or fee level could lead to additional interest rate costs on fixed-rate mortgages. The results show that a redistribution between lenders and consumers and net social effects of intervention are only small. The policy options located in the centre of the curve – symmetric and asymmetric fair value compensations – show the least aggregate swing of all policy options.

Regarding the responsible lending policy options, the study sees some of the policy options presented namely, the credit assessment, adequate explanations and an obligation to refrain from lending – as potentially powerful instruments to address a wide range of the issues

[185] See footnote 184.

identified. But the study also notes operability problems due to lack of specificity in the current formulations, questions of legal consequences and implementation that might therefore limit their effectiveness.

4.2. Study on consumer testing of possible new format and content for the European Standardised Information Sheet (ESIS) on home loans

This study, carried out on the Commission's behalf by Optem was published in October 2009.

The study aimed at identifying consumers' information needs when looking for a mortgage loan and how that information could be best presented to them in order to help them understand the loan's characteristics and risks. The objective was to improve the format and content of an already existing information sheet (ESIS) so that it really assists the consumer in taking an informed decision. To that end, the contractor tested directly with consumers enhanced versions of the ESIS. This included new information items such as risk warnings and presented existing ones more clearly. Consumers' feedback on this new version was very positive.

4.3. Study on Credit Intermediaries in the Internal Market

This study, carried out on the Commissions behalf by Europe Economics, was published on 15 January 2009[186].

The purpose of the study was to analyse the EU credit intermediation market, to review the regulatory framework in which credit intermediaries operate, and to examine possible consumer detriments. The main findings of the study were as follows: First, credit intermediaries play an important role in the mortgage and consumer credit markets, primarily in market search, product distribution and provision of advice. Mortgage intermediation is by far the most important market. Second, borrowers often rely heavily on credit intermediaries to alleviate information asymmetry. The fact that credit intermediaries often offer advice, opens up the possibility of market failure due to the misalignment of incentives, as the intermediary is remunerated based on commission from the lender. Third, there is a gap and inconsistencies in the regulation of credit intermediaries at EU level. These gaps have the potential to give rise to considerable consumer detriment.

4.4. Study on equity release schemes in the EU

This study, carried out on the Commissions behalf by Institut für Finanzdienstleistungen e.V. was published on 18 March 2009[187].

Equity Release Schemes (ERS) transform fixed assets in owner occupied dwellings into liquid assets for private pensions. The study identifies two types of ERS and focuses on schemes provided as financial services. The study identifies a number of barriers to the development of equity release markets.

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186 See footnote 6.
187 http://ec.europa.eu/internal_market/finservices-retail/docs/credit/equity_release_part1_en.pdf

4.5. Study on the role and regulation of non-credit institutions in EU mortgage markets

This study, carried out on the Commission's behalf by UK-based economic consultancy London Economics, was published on 19 September 2008[188].

The study forms part of the research identified in the *White Paper on the Integration of EU Mortgage Markets* published in 2007. The study examines the activities, regulation and supervision of mortgage lenders that are not registered as 'credit institutions' under domestic law. It shows that in the majority of Member States, lenders operating outside the EU legal framework for credit institutions are regulated and supervised by national authorities, and that their national market share is small compared with that of fully-fledged credit institutions.

4.6. Study on the costs and benefits of integration of EU mortgage markets

This study, carried out on the Commission's behalf by UK-based economic consultancy London Economics, was published on 5 August 2005.[189]

The study's objective was to analyse and provide a quantitative assessment the costs and benefits for the European economy of integrating the European mortgage credit market, taking into account of the impact on both European lenders and consumers. The study also provided a description of the current situation of mortgage markets and the extent to which they are already integrated, including an assessment of cross-border trade in mortgage credit services as well as an examination of current trends and an analysis as to how these might impact on the cross-border situation. The study also assessed to what extent there was consumer and lender appetite for a pan-European mortgage market.

5. IMPACT ASSESSMENT STEERING GROUP

An Interservice Impact Assessment Steering Group was established in October 2009 to help prepare the Impact Assessment accompanying the initiative on responsible lending and borrowing. The Steering Group was chaired by Internal Market and Services DG and representatives of DG Health and Consumers, DG Enterprise and Industry, DG Competition, DG Economic and Financial Affairs, DG Employment, and the Secretariat General all actively participated in the preparation of the Impact Assessment. The European Central Bank also participated with a consultative role. The Steering Group met on three occasions: 23 October 2009 and 11 December 2009 and 13 July 2010.

The main messages of the Steering Group were the following.

– The impact assessment steering group (IASG) emphasised the importance of a robust impact assessment given the political importance of mortgage credit to all stakeholders. They welcomed the work undertaken and indicated their broad agreement on the text, subject to incorporation of the changes discussed as well as to final agreement using written procedure.

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188 http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/non-credit/non_banks_report_en.pdf

189 http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/2005-report-integration-mortgage-markets_en.pdf

– The IASG discussed the length of the document and considered that that this was a particularly complex impact assessment and that the length of the report could not be reduced without compromising the self-standing nature of the document.

– In addition, the IASG debated on the balance between the relative importance of the internal market arguments and the consumer protection arguments for an initiative on responsible lending. The IASG concluded that both aspects were equally important.

– The IASG requested to more clearly measure an initiative on responsible lending and borrowing against the subsidiarity and proportionality tests. In addition, the IASG considered emphasising that the intention of the proposal is not to foster the internal market at the expense of consumer protection. The group also requested to further develop the financial stability considerations.

– With regard to the policy option, the IASG required to indicate if implementing or technical measures were considered in certain areas, and to reflect this in the description of the policy options.

6. IMPACT ASSESSMENT BOARD

The impact assessment was presented to the Impact Assessment Board on 22 September 2010. The Impact Assessment Board adopted its opinion on 24 September 2010. The Board concluded that the report provides the necessary evidence base for action in this area. The Board focused on four main recommendations to improve the Impact Assessment Report. These recommendations have been incorporated into this revised version of the Impact Assessment Report.

The main recommendations of the Impact Assessment Board were to:

– provide an explicit definition of responsible lending and borrowing and to clarify the magnitude of the problem, in particular by explaining the magnitude of the problems in the EU, qualifying its relevance relative to other causes of the financial crisis, and assess the importance of the specific drivers addressed by the initiative in question;

– strengthen the analysis of subsidiarity and proportionality, in particular emphasising the consumer protection and financial stability angles;

– clarify the analysis of the impacts in particular for principles-based guidance on remuneration schemes, qualification of the existing biases in the estimations, and the impact of reduced access for low income households;

– reduce the length of the text, in particular Section 4 and the number of footnotes.

Following the receipt of the opinion of the Impact Assessment Board, the following changes were made.

– An explicit definition of responsible lending and borrowing was introduced in the introduction (Section 1 of the Impact Assessment Report).

– The magnitude of the problem was developed and expanded in Section 3.1. Further analysis was undertaken and additional evidence to support the arguments integrated.

– The drivers of irresponsible lending and borrowing have also been expanded to include aspects other than market and regulatory failures. Aspects such as the influence of the general economic situation and other factors such as low levels of financial literacy are also given due consideration. See Section 3.2.

– The consequences of irresponsible lending and borrowing have also been considered in more depth, in particular by integrating a section on the potential impact of spill-over effects to the macroeconomy.

– Section 5 on subsidiarity has been elaborated. In particular, the evidence for and analysis of the consumer protection and financial stability angles has been developed.

– In terms of proportionality, the relevant section has been moved from Section 5 to 6.9. An overview of the different levels of harmonisation under consideration has been inserted to improve transparency in Section 6.9.3 and illustrate the targeted approach adopted.

– The analysis of principles-based guidance on remuneration schemes has also been further developed both in the Report and Annex 4.

– In Section 6.1 and Annex 5, the methodological assumptions have been clarified and additional information added, where necessary, in order to ensure that any biases in the estimations are acknowledged and transparent.

– Throughout the Report and Annexes 4 and 5, the potential impact of reduced access for low income households has been expanded to consider both the costs and benefits.

– The large majority of presentational proposals have been made, for example, the Tables on illustrating the costs and befits of the policy options for each topic have been introduced to the Impact Assessment Report.

– Every effort has been made to reduce the length of the report while at the same time integrating the different comments received from the Board.

ANNEX 3 – Analysis of application of Consumer Credit Directive to mortgage credit

1. INTRODUCTION

In order to assist with the assessment of the impacts of this Responsible Lending and Borrowing initiative, national authority experts in the field of mortgage credit were asked to complete a questionnaire on the application of provisions of the Consumer Credit Directive (hereinafter 'the CCD') to mortgage credit. 28 responses were received to the questionnaire from 26 Member States[190] and one EEA member, Norway.

2. ADVERTISING

2.1. Article 4: Standard information to be included in advertising

Austria, Bulgaria, Cyprus, Denmark[191], Finland, Germany, Italy, Norway, Portugal[192], Romania, Slovenia, Malta and Sweden intend to apply Article 4 of the CCD to mortgage credit. The Czech Republic, Hungary, Ireland, Lithuania, Luxembourg and Poland do not intend to apply this article to mortgage credit.

France and Spain have similar provisions in their national legislation which cover mortgage credit. Estonia intends to apply the article but only to the APRC and will use the exception as per Article 4(1). Slovakia, Latvia and the Netherlands intend to apply the provision but will exclude the APRC.

Two responses were received from Belgium. The response of the SPF Economie & Commission Bancaire states that they do not intend to apply the article unless the mortgage credit is not related to real estate and the second response, from Financière et des Assurances, states that the article will not be applied. For the purposes of this survey Belgium are therefore considered as not applying Article 4 to mortgage credit.

The United Kingdom state in their response that their mortgage rules require all advertising to be clear, fair and not misleading and that they have several prescriptive requirements support this general obligation.

2.2. Article 21(a): Obligations of credit intermediaries in advertising

Article 21(a) requires that a credit intermediary indicate in advertising the extent of his powers, in particular whether he works exclusively with one or more creditors or as an independent broker. Austria, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, Poland, Norway, Portugal, Slovakia, Romania, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. Belgium, Bulgaria, Cyprus, Czech Republic, Ireland, Lithuania, Luxembourg, the Netherlands and the United Kingdom[193] do not intend to apply to article.

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190 No response was received from Greece. Two responses were received from Belgium (SPF Economie & Commission Bancaire, Financière et des Assurances (CBFA)).
191 However they are excluding application to mortgage banks.
192 This article is already in use in Portugal.
193 But where a service description is given it must be accurate. If the intermediary typically charges a fee, then this must be disclosed in the advertisement.

France[194] in its consumer code and Spain in specific financial intermediaries' legislation, have similar provisions in their national legislation which concern mortgage credit.

3. ARTICLE 8: CREDITWORTHINESS

Article 8 introduces an obligation to assess the creditworthiness of the consumer. Austria, Belgium, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, the Netherlands, Norway, Romania, Slovakia, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. The Czech Republic, Ireland, Lithuania[195], Luxembourg, Portugal, Spain and United Kingdom[196] do not intend to apply this article to mortgage credit.

French case law provides for a warning duty of the borrower, which implies an assessment of creditworthiness. Poland has some obligation to assess creditworthiness, which stems from the Polish Act of Banking law in case of mortgage credits.

4. ARTICLE 9: DATABASE ACCESS

Article 9 requires non-discriminatory access to databases. Austria, Belgium, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany[197], Hungary, Italy, Latvia, the Netherlands, Norway, Romania, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. The Czech Republic, Ireland, Lithuania, Luxembourg, Poland, Portugal, Spain and United Kingdom[198] do not intend to apply this article to mortgage credit.

France already provides non-discriminatory access to databases and Slovakia has chosen to apply the provision only on a reciprocity basis.

5. ARTICLE 20: REGULATION OF CREDITORS

Article 20 ensures that all creditors are supervised by a body or authority independent from financial institutions, or regulated. Austria, Belgium, Bulgaria[199], Cyprus, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia[200], the Netherlands, Norway, Romania, Slovakia, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. The Czech Republic, Ireland, Luxembourg and Spain do not intend to apply this article to mortgage credit.

The United Kingdom does not intend to apply this provision to mortgage credit but have mortgage rules that require the authorisation and supervision of first charge residential

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194 L. 321-2 of the consumer code.

195 However laws regulating the activities of commercial banks require evaluating the financial possibilities of consumers.

196 However firms must lend responsibly and be able to demonstrate that they took account of the individual's ability to repay.

197 Beyond the scope of the CCD all consumer credits (mortgage and others) with an amount of at least EUR 200 are covered.

198 No legal requirement but private registers use an approach that is non-discriminatory and based on reciprocity of access.

199 Exercised by the Commission on Consumer Protection within the Ministry of Economy and Energy.

200 Supervised by Consumer Rights Protection Centre and will have to receive license for granting credit to a consumer.

mortgage lenders. Second and subsequent charge lenders are licensed by the Office of Fair Trading under the Consumer Credit Act. Poland has a similar provision; the Polish Financial Supervision Authority (PFSA) is responsible for supervision of financial market especially in case of mortgage credits. Also in Lithuania it is mainly commercial banks that provide mortgage credits and they are supervised by the Lithuanian Central Bank. France already provides for the supervision of creditors, and in Portugal credit institutions are regulated and supervised by the Banco de Portugal as far as retail banking products and services are concerned according to the Legal Framework of Credit Institutions and Financial Companies.

6. POST-CONTRACTUAL TREATMENT OF CONSUMERS

6.1. Article 17: Assignment of rights

Article 17 deals with the assignment of rights. Austria, Belgium, Cyprus[201], Denmark[202], Estonia, Finland, Germany, Hungary, Italy, Latvia, Norway, Romania, Slovakia, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. Czech Republic, Ireland, Lithuania, Luxembourg, the Netherlands, Poland and the United Kingdom[203] do not intend to apply this article to mortgage credit.

A number of Member States have similar provisions in their national legislation; Spain has a similar provision in specific mortgage credit legislation, France in its Civil Code, Bulgaria[204] in its Law on Obligations and Contracts and Portugal in its Civil Code.

6.2. Article 24: Out-of-court dispute resolution

Article 24 provides for out-of-court dispute resolution. Austria, Belgium, Denmark[205], Estonia, Finland, Germany, Hungary, Italy, Latvia, Norway, Romania, Slovakia, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. Cyprus[206], Czech Republic, Ireland, Luxembourg, Portugal and Poland do not intend to apply this article to mortgage credit.

The United Kingdom do not intend to apply this provision to mortgage credit but all secured lenders are already subject to out of court dispute resolution provided, by the Financial Ombudsman Service. Spain has a specific regulation related to consumer rights and ADR for credit institutions, Lithuania partially applies the provision in its Law on Consumer Rights Protection which gives consumers the right to deliver a dispute to an out of court dispute scheme, France has a similar provision in civil law and Bulgaria[207] has a similar provision in its Law on Obligations and Contracts.

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201 Remains under consideration.

202 Applied partially, with an exemption to Article 17(2), where another result follows from the Danish rules on registered security interests in real estate.

203 UK mortgage rules oblige firms to disclose who is the true lender.

204 The consumer’s (debtor’s) rights (and creditor’s obligations) in the case of assignment of creditors rights to a third party are subject to Articles 99–100 of Law on Obligations and Contracts. These provisions are also applicable to mortgage credit contracts.

205 With an exemption to Article 17(2) where another result follows from the Danish rules on registered security interests in real estate.

206 Under consideration.

207 See footnote 204.

7. PRE-CONTRACTUAL INFORMATION AND ADEQUATE EXPLANATIONS

7.1. Article 5(1)–(4): Pre-contractual information

Article 5(1)–(4) sets out the pre-contractual information to be provided to the borrower. Austria, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany[208], Latvia[209], Italy, Norway, Poland[210], Romania, Slovakia, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. The Czech Republic, Ireland, Lithuania, and Luxembourg do not intend to apply this provision to mortgage credit.

French legislation is built on a distinction between preliminary offer (that is, the contract before it is signed) and the contract (after signature). Therefore, the mandatory information in the contract is given to the borrower before the signature. UK mortgage rules require prescriptive product disclosure in the form of the Key Facts Illustration (KFI) which they state extend beyond the Standardised European Consumer Credit Information (SECCI) or the European Standardised Information Sheet (ESIS). Hungary, applies the rules of the Commission Recommendation (2001/193/EC) on pre-contractual information to be given to consumers by lenders offering home loans as mandatory for pre-contractual information. The Netherlands also have rules concerning pre-contractual information in the Code of Conduct for Mortgage Lending. Spain has already provided for this provision in its specific mortgage credit legislation and Belgium also has a similar provision. Portugal also provides for a similar provision for which a new notice is due to be published.

7.2. Article 7: Exemption for pre-contractual information requirements for intermediaries

Article 7 provides for an exemption from the pre-contractual information requirements for intermediaries who act in an ancillary capacity. Austria, Denmark, Estonia, Finland, Germany, Italy, Latvia, Norway, Portugal[211], Romania, Slovenia, Malta and Sweden intend to apply the article to mortgage credit. Belgium[212], Bulgaria, Cyprus, Czech Republic, France, Hungary, Ireland, Lithuania, Luxembourg, the Netherlands, Poland, Slovakia and Spain do not intend to apply the article to mortgage credit.

The United Kingdom does not intend to apply the provision to mortgage credit but have rules which apply to any credit intermediaries acting in the course of business.

7.3. Article 21: Information on fees payable by consumer

Article 21(b) & (c) require information to be provided on the fees payable by consumer to a credit intermediary. Austria, Cyprus, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, Malta, the Netherlands, Norway, Poland, Portugal, Romania, Slovakia and Sweden

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[208] Partial application, the specialities of mortgage credits are taken into account.

[209] Partial application, with exceptions of 5(1)(g) and (o). Application of Article 5 to mortgage credits is still under discussion.

[210] Poland modified the obligations resulting from Article 5(1)–(4) CCD taking into account the specification of mortgage credit products.

[211] Specific legislation on credit intermediaries is currently being prepared.

[212] But applies if the mortgage credit is not related to immovable property.

intend to apply the article to mortgage credit. Belgium[213], Bulgaria, Czech Republic, Ireland, Lithuania, Luxembourg and Slovenia[214] do not intend to apply the article to mortgage credit.

The United Kingdom has a similar provision in its mortgage rules which require the broker to state typical fees in advertising and to include them in pre-sale disclosure. In France, information concerning fees is provided for by the general dispositions of the consumer code. Spain has a similar provision in specific mortgage credit and financial intermediaries' legislation.

7.4. Article 5: Adequate explanations

Article 5 (6) requires the provision of adequate explanations by creditor or intermediary. Austria, Belgium, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, Malta, the Netherlands, Norway, Romania, Slovakia, Slovenia and Sweden intend to apply the article to mortgage credit. Bulgaria, Cyprus, Czech Republic, Ireland, Lithuania, Luxembourg, Poland and Portugal do not intend to apply the article to mortgage credit.

UK mortgage rules require a firm to provide disclosure and explain the importance of reading it. Currently there is no requirement to talk through the key product risks and features.

In France, adequate explanations are partially covered by the warning duty defined by case law. Spain has a similar provision in specific mortgage credit and financial intermediaries' legislation.

7.5. Annex II: Standardised European Consumer Credit Information (SECCI)

Annex II sets out the SECCI that should be provided to the borrower. Austria, Belgium, Bulgaria, Cyprus, Denmark, Estonia, Latvia[215], Malta, Norway, Romania, Slovakia and Slovenia intend to apply the article to mortgage credit. Czech Republic, France, Germany[216], Hungary[217], Ireland, Lithuania, Luxembourg, the Netherlands and Spain do not intend to apply the article to mortgage credit.

The UK mortgage rules contain prescriptive disclosure (the KFI), which they state extend beyond the SECCI or the ESIS, however second and subsequent charge mortgage lenders may use the SECCI if they choose to do so. Finland has an obligation regarding information and the SECCI is one method of fulfilling this obligation. Poland modified the SECCI so as to take into account specifications of mortgage credit. Portugal is preparing to publish a notice by the Banco de Portugal, which takes into account not only the SECCI's components but also the financial plan, as well as the plain vanilla one to comparison purposes and the APRC. In Sweden, the information contained in the SECCI must be given, however the form is not mandatory. Italy do not as of yet know whether they will be applying the SECCI to mortgage credit.

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213 See footnote 212.

214 An intermediary is not allowed to request any fees.

215 Under discussion.

216 But German law will allow the use of a slightly modified version of the European Standardised Information Sheet ESIS.

217 Rather rules of the 2001/193/EC Recommendation are mandatory.

8. CONTRACTUAL INFORMATION

8.1. Article 10: Information to be included in the credit contract

Article 10 sets out the information to be included in the credit contract. Austria, Belgium, Cyprus, Estonia, Finland[218], Germany[219], Hungary[220], Italy, Latvia[221], Malta, Norway, Poland[222], Portugal, Romania, Slovakia, Slovenia, Spain and Sweden intend to apply this article to mortgage credit. Bulgaria, Czech Republic, Ireland, Lithuania, Luxembourg and the Netherlands do not intend to apply this article to mortgage credit.

French legislation already provides for mandatory information in contracts of mortgage credit. UK mortgage rules require the repetition of pre-sale disclosure (the KFI) with additional information requirements. In Denmark, the information is to be provided before contract conclusion. If the data is provisional in nature, definitive information is to be given as soon as possible.

8.2. Article 11: Information concerning the borrowing rate

Article 11 requires the provision of information on the borrowing rate. Austria, Belgium, Cyprus, Denmark[223], Estonia, Finland, Germany, Hungary, Italy, Latvia, Malta, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, and Sweden intend to apply this article to mortgage credit. Bulgaria, Czech Republic, Ireland, Lithuania, Luxembourg, the Netherlands and Spain do not intend to apply this article to mortgage credit.

French legislation already provides for annual information of the amount of capital that must be reimbursed when the borrowing rate is variable. UK rules oblige firms to give notice on changes in rates, and monthly payments, in certain circumstances. Spain provides for a similar provision in specific mortgage credit legislation.

9. ANNUAL PERCENTAGE RATE OF CHARGE

9.1. Article 3(g)–(i): Definition of APRC

Article 3(g)–(i) defines the key terms used in calculating the APRC. Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Norway, Romania, Slovenia, Spain[224] and Sweden intend to apply this Article to mortgage credit. Bulgaria, Belgium, Czech Republic, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Slovakia and the United Kingdom do not intend to apply this Article to mortgage credit.

In Finland, the basic definition of APRC is applied to mortgage credit, but insurance costs for the real estate given as collateral are not taken into account. The UK approach to calculating the APRC for mortgages is closely related to existing UK method used for consumer credit

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[218] Largely corresponds with Finnish Article 11.
[219] But the specifics of mortgage credit is taken into account.
[220] Excluding some items not relevant to mortgage contract.
[221] Except for Article 10(2)(g), (p) and (q).
[222] Poland took into account the specification of mortgage credit products.
[223] For loans based on floating rate bonds the information on changes in the borrowing rate can be given after the alteration.
[224] Provided for in specific mortgage credit legislation.

and UK unsecured credit rules have required little amendment to reflect the newly agreed CCD. French legislation already provides for annual information of the amount of capital that must be reimbursed when the borrowing rate is variable. In Portugal the APR is net of taxes[225].

9.2. Article 19 and Annex I: Calculation of APRC

Article 19 and Annex 1 further define how the APRC should be calculated. Austria, Cyprus, Denmark, Estonia, Germany[226], Hungary, Malta, Norway, Romania, Slovenia, Spain[227] and Sweden intend to apply this Article to mortgage credit. Belgium, Bulgaria, Czech Republic, France, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland and Slovakia do not intend to apply this Article to mortgage credit.

Finland is applying the article with some additional presumptions for home loans. Germany is also applying the article with the exception of costs for securities, which are not part of the calculation. In Portugal, the APR is net of taxes[228]. The UK approach to calculating the APRC for mortgages is closely related to existing UK method used for consumer credit and UK unsecured credit rules have required little amendment to reflect the newly agreed CCD.

10. RIGHT OF WITHDRAWAL

Article 14 provides for a period of 14 calendar days in which to withdraw from the credit agreement. Cyprus, Germany, Italy, Malta, Norway[229], Romania and Slovenia intend to apply this article to mortgage credit. Austria, Belgium, Bulgaria, Czech Republic, Estonia, Finland, France[230], Hungary, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Slovakia, Spain and Sweden do not.

Denmark intends to apply the provision but the rule will not apply to loans based on bonds. Norway also intends to apply the provision but with an exception from the right to withdraw for credit agreements above NOK 700 000 (approximately EUR 84 377) with fixed interest rates. In the United Kingdom, there is no right of withdrawal in mortgage rules, except in those circumstances where European legislation has created such a right (e.g. on doorstep sales).

11. OTHER ARTICLES OF CONSUMER CREDIT DIRECTIVE BEING EXTENDED TO MORTGAGE CREDIT

Austria intends to apply Article 15 (linked credit agreements) and Article 16 (early repayment) in an amended form.

Estonia intends to apply Article 13 (open-end credit agreements) and Article 16 (early repayment).

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225 The Decree-law no. 220/1994 sets up the definition and the calculation method of the APR.

226 Except for costs for securities.

227 In specific mortgage credit legislation.

228 The Decree-law no 220/1994 sets up the definition and the calculation method of the APR.

229 There is an exception from the right to withdraw for credit agreements above NOK 700 000 (approximately EUR 84 377) with fixed interest rates.

230 French legislation provides for a minimal 'reflexion period' of 10 days before the contract can be signed.

Finland intends to apply Article 16 (early repayment) However, the grounds according to which the creditor is entitled to compensation are slightly different than in consumer credits. Furthermore, the rules on the amount of compensation to which the creditor is entitled are different from those in the CCD.

Germany intends to apply Article 15 (linked credit agreements) but in the case of financed purchase of real property or equivalent rights only if the creditor himself transfers the real property or the equivalent right or if the creditor promotes the purchase beyond disbursing the loan.

Hungary intends to apply further restraints on the chargeable fees in case of prepaying the mortgage debt, but the maximum rates are higher.

ANNEX 4 – Detailed Impact Assessment

1. ADVERTISING AND MARKETING

1.1. Context

Credit products and services are generally communicated, promoted and sold to consumers through the use of marketing techniques, which include advertising in various public means of communication. In that sense, marketing is defined as a communications-based process through which a trader informs or persuades individuals and communities that existing and newly-identified needs and wants may be satisfied by the products and services he offers. Advertising, which constitutes a marketing practice, is defined in Directive 2006/114/EC as "the making of a representation in any form in connection with a trade, business, craft or profession in order to promote the supply of goods or services (…)"[231]. Advertising, and particularly financial advertising such as that for mortgage credit, has a massive influence on the decisions people make[232].

The institutions that are most commonly identified as the ones engaged in advertising and other marketing practices to promote mortgage credit products and services are credit institutions, non-credit institutions (NCIs), and credit intermediaries whether they be tied or independent agents or perform credit intermediation in a full or ancillary capacity[233]. The target audience consists of consumers in general, or particular segments of consumers who are likely to be interested in purchasing mortgage credit products. Various public means of communication are used in advertising, the main ones being electronic media (radio, television, internet, phone or sms) and print media (newspapers, magazines, flyers, catalogues, billboards).

While marketing and advertising are today of paramount importance for providers to reach their target consumer segments and often to create a competitive advantage, there are some providers who use the power of public communication tools to exploit consumers, leading to consumer detriment. The reasons for engaging in this sort of behaviour is to increase revenues and profits by appearing more price-competitive than their rivals (increase market share) and by inducing consumers who would otherwise not have got credit into doing so (increase market size). This behaviour, if left unaddressed, can lead to a serious distortion in competition, promote wider use of misleading practices, reduce consumer confidence, increase overindebtedness, and negatively affect financial stability.

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231 European Parliament and Council Directive 2006/114/EC, Article 2(1), concerning misleading and comparative advertising.

232 Financial Services Authority (UK), 28.11.2006, www.fsa.gov.uk/pages/Library/Communication/PR/2006/125.shtml.

233 According to the Consumer Credit Directive (2008/48/EC), "suppliers of goods and services may be deemed, for example, to be acting as credit intermediaries in an ancillary capacity if their activity as credit intermediaries is not the main purpose of their trade, business or profession". This is often the case with, for example, car dealers who advertise and arrange credit for the customer to finance the purchase of the car he buys from the dealer.

1.2. Overview of the legislative framework

Various rules and standards are in place at the Community and Member State level to prevent misleading marketing and advertising practices from materialising.

1.2.1. EU level

At the Community level, a number of rules and standards already exist in relation to marketing and advertising of credit products and services. In particular, the Misleading and Comparative Advertising Directive lays down certain rules to protect traders from misleading advertising[234]. This Directive however only applies to businesses (B2B) and not to consumers (B2C). The Unfair Commercial Practices Directive lays down a general prohibition on misleading and aggressive commercial practices[235]. The Directive states that misleading commercial practices includes misleading advertising[236], thus covering misleading mortgage credit marketing and advertising practices. Articles 6 and 7 of the Directive provide that both misleading actions and misleading omissions constitute misleading commercial practices if they cause or are likely to cause the average consumer to take a transactional decision he would not have taken otherwise. Whether or not the information communicated or provided is factually correct is irrelevant.

Specific sectoral Community legislation relating to credit marketing and advertising came into effect in May 2010 under the CCD[237]. This Directive contains specific provisions on advertising concerning credit agreements for consumers as well as a list of standard information that must be included in the advert whenever certain conditions are met. In particular, Article 4(1) states that "any advertising concerning credit agreements which indicates an interest rate or any figures relating to the cost of the credit to the consumer shall include standard information (…)". Article 4(2) lists the standard information that must be provided in a clear, concise and prominent way by means of a representative example:

a) the borrowing rate –fixed, variable or both;

b) the total amount of credit;

c) the annual percentage rate of charge;

d) if applicable, the duration of the credit agreement;

e) if applicable, the cash price and the amount of any advance payment;

f) if applicable, the total amount payable by the consumer and the amount of the instalments.

Furthermore, Article 21(a) requires a credit intermediary to indicate in advertising material the extent of his powers, and in particular, whether he works exclusively with one or more creditors or as an independent broker.

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234 Directive 2006/114/EC, Article 1.

235 European Parliament and Council Directive 2005/29/EC.

236 See footnote 235, Recital 14.

237 *Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC,* Article 4.

The CCD however, only applies to consumer credit and does not cover other forms of credit such as mortgage products and services. It also only applies to credit agreements involving a total amount of credit from EUR 200 up to EUR 75 000.

1.2.2. Member State level

At Member State level, legislation is currently widely diverging regarding credit marketing and advertising practices[238].

While most Member States require the inclusion of an APRC in credit advertising[239], the Study on Credit Intermediaries in the Internal Market found that "Member States that require compliance with specific [credit advertising] standards are Austria, Belgium, Bulgaria, Czech Republic, Hungary, Ireland, Italy, Malta, the Netherlands, Slovenia, the United Kingdom, and Sweden. In several instances, there are no specific rules on marketing and advertising, but the general rules in the relevant marketing/advertising legislation would apply"[240]. The inference from this is that consumers in many Member States are afforded the protection granted by general prohibitions such as those found in the Unfair Commercial Practices Directive as specific rules on the advertising and marketing of mortgage credit products does not exist in several Member States.

A final issue relates to the transposition of the CCD. 18 Member States (Austria, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, Malta, the Netherlands, Portugal, Romania, Sweden, Slovakia, Slovenia, the United Kingdom.) have chosen to extend the scope of the Directive to other types of credit (i.e. mortgages). Nevertheless, those countries that do not already have sectoral legislation and which will not extend the scope of the CCD to other types of credit will end up with a lower level of consumer protection in respect of mortgage credit advertising practices.

1.3. Problem description

1.3.1. Risk of consumers being misled by unbalanced, unclear or incomplete mortgage credit advertising or marketing

Mortgage credit products are complex financial products that often constitute one of the longest and most important financial commitments that borrowers undertake in their lifetime. It is therefore imperative that mortgage credit advertisements do not potentially mislead or deceive a consumer into making a transactional decision he/she would not otherwise have made. Appropriate advertising enables the consumer to make informed judgements concerning credit products and services marketed to him and act in his best interest. Given the ever growing complexity of such products and services, as well as the fact that a large number of consumers do not possess an adequate level of financial literacy[241], there is a strong case for ensuring that credit advertising is indeed clear, balanced, and complete.

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238 *Impact Assessment of the Proposed Directive on Consumer Credit*, European Parliament, 2007.

239 See footnote 136, Annex B: Legal Summaries. Inclusion of an APRC (Annual Percentage Rate of Charge) is not required in Germany, Greece, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands and Romania.

240 See footnote 6.

241 A Eurobarometer survey has demonstrated that 59 % of Europeans find it too difficult to understand the information given to them on how their mortgages work. See, *Special Eurobarometer 230* and *Special Eurobarometer 298*. The issue of financial education is also being examined in a separate initiative: The

Cases of inappropriate marketing and advertising practices with respect to credit products and services are found across the EU[242]. Examples include: unrealistic offers such as zero interest rate and free intermediation (Poland); advertising targeted at sub-prime borrowers which included promises of 'deleting' credit histories and unconditional access to credit (Italy); omitting of the APRC (where its inclusion is obligatory); and advertising the lowest possible rate that is not available to the average consumer but only available in very rare instances (Hungary).[243] In the Netherlands, a recent report into the collapse of DSB Bank concluded that stated that DSB had an aggressive marketing policy, in which it successfully gave the impression that it was one of, if not *the* cheapest credit provider on the market.[244] It said that this was important, as most customers are only interested in the lowest interest rate or the lowest monthly repayments.[245]

In these examples, consumer detriment is caused by asymmetric and incomplete information, that is, the exploitation of the consumers' limited knowledge and financial literacy. By containing unclear, unbalanced and/or incomplete information, these advertisements can mislead or deceive the consumer and can cause him to take a transactional decision he would not have taken otherwise. Even if the communication to the public is factually correct, it still may have the potential of misleading the consumer, for example, it may fail to include other critical information, or provide an unfair presentation in terms of the legibility of the offer and the prominence of the various items of information. Such a practice could be in breach of the Unfair Commercial Practices Directive. An example of such a scenario could be where a mortgage credit advertisement indicates an interest rate or any figures relating to the cost of the credit, without also indicating the annual percentage rate of charge, the total amount and duration of the credit, whether the rate is fixed or variable, etc; or where the advertisement does contain such additional information, but in a way not prominent or legible enough given their importance (i.e. small print, insufficient air time, etc).

Data suggests that inappropriate mortgage credit advertising constitutes at least one of the causes that led to mortgage loans being granted to many consumers who should not have obtained them. On the one hand, evidence from the United Kingdom clearly shows that high-risk lending was mainly practiced by non-banks who sought a growth in market share by targeting sub-prime consumers (credit-impaired, no income verification, etc). Between 30–60 % of borrowers on these lenders' mortgage books are now in arrears[246]. On the other hand, these sub-prime consumers who previously had limited or no access to mortgages became the subject of marketing and advertising communications by the aforementioned creditors, as they constituted their target consumer segment. In the Netherlands too, the report into the collapse of DSB Bank stated that advertising and marketing campaigns by DSB targeted those individuals on low incomes and with low levels of education.[247]

Commission has set up an expert group on financial education and has established a European Database on Financial Education (EDFE) as a new information tool on the wide range of the schemes available across the EU. See for more information http://ec.europa.eu/internal_market/finservices-retail/capability/index_en.htm.

[242] See footnote 6. For the United Kingdom, see Advertising Standards Authority (Adjudications), at http://www.asa.org.uk/asa/adjudications/public/.

[243] See footnote 6.

[244] *Rapport van de commissie van Onderzoek*, DSB Bank, 23.6.2010.

[245] See footnote 244.

[246] *DP09/3 Mortgage Market Review*, Financial Services Authority, October 2009, http://www.fsa.gov.uk/pubs/discussion/dp09_03.pdf.

[247] See footnote 244.

In many cases, these communications were misleading[248]. In the context of the Commission's Public Consultation on Responsible Lending and Borrowing, a large number of respondent organisations presented examples of unfair or aggressive marketing and advertising practices towards consumers in general and low income or low financially literate consumers in particular: predatory marketing; cold calls to welfare recipients; rates higher than those advertised; advertising targeted to social rented tenants; credit impaired, and other low income households implying that they can get mortgages despite their circumstances; SMS loans; 'buy now, pay later' adverts that omit to use terms such as 'credit' or 'loan'; 'no creditworthiness check' adverts; direct advertising to already overly indebted borrowers involved in collective debt settlement procedure, etc. In the Netherlands, for example, in 2005 DSB Bank was criticised by the regulator for the use of banner advertisements on the internet as they did not contain the prescribed information, however DSB argued that a banner was not a self-standing advertisement and should be seen in combination with the website to which a link in the advert was connected.[249] It is therefore plausible to argue that at least some of these sub prime borrowers with no previous access to credit and who are now in or close to default were led to believe – via inappropriate marketing and advertising practices – that they too could get a mortgage despite their circumstances; and they duly applied and were approved for a mortgage, despite their unsuitability for it, contributing to the now well known phenomenon of overindebtedness, defaults, and repossessions for this class of borrowers.

Misleading or deceptive mortgage credit advertisements can cause consumers to buy credit products and services that are inappropriate for them or that they do not really need. This can be a serious cause of consumer detriment, leading to a rise in overindebtedness, difficulties by some borrowers, particularly the most vulnerable, in servicing their debts, and even to credit defaults and foreclosures/repossessions. A further likely consequence is a drop in consumer confidence, as consumers have less trust in the credit products and services that are marketed and sold to them, as well as the institutions that provide them.[250] Cross-border customer mobility will also be impacted since consumers who exhibit less trust in respect of credit advertising in their own Member State, will be less likely to respond to advertising for credit products and services offered in other Member States. Cross-border business may also be negatively impacted by imposing dual/multiple burdens on mortgage credit distributors – in the sense that they may have to adapt marketing and advertising practices/IT tools/rule books to comply with, for example, different requirements of sectoral legislation in another Member State. Finally, there is a possibility for a negative impact on financial stability, caused by the aforementioned likelihood of overindebtedness, defaults, and foreclosures.

1.3.2. Difficult for consumers to compare advertised products

Consumers often face substantial difficulties in understanding and comparing different mortgage credit offers due to the ever growing number and complexity of credit products[251]

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248 *Press Release*, Financial Services Authority, 28.11.2006: Many mortgage brokers in the sub-prime market were found to issue poor advertising and promotional materials, with more than 200 of them told by the FSA to withdraw or amend misleading advertising.

249 See footnote 244.

250 A survey by UK consumer organisation, Which? "showed that nearly half of consumers (43 %) believe that banks would not be sympathetic if they got into financial difficulty, and well over a third (37 %) didn't trust financial institutions to act in the best interests of the UK economy", http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0715_at.shtml.

251 For instance, 62 % of consumers would like mortgage credit products to be simplified, *Flash Eurobarometer 282, March 2010*.

and services that are being marketed to them, and the low level of financial literacy that many of them possess. These difficulties become even greater when mortgage credit advertising is not governed by specific rules to ensure that it remains clear, balanced and complete. In the absence of such rules, it is likely that consumers not only find it hard to decide which one among the credit products and services marketed to them is the most advantageous, but that they may also erroneously conclude that a particular product is more advantageous than others when in fact it is not.

In advertising their credit products and services, creditors go into considerable lengths to devise ways to make their offers appear attractive, appealing, advantageous, and of added value compared to those of competitors. They often try to do this by carefully deciding what information should be included and which should be omitted, how that information should be communicated, how prominent and legible each piece of information should be, etc. As it has already been discussed in the previous section, this sort of conduct can cause consumer detriment because it has the potential to mislead a consumer, whether the information provided is factually correct or not. A consumer for example may be misled into erroneously believing that one advertised mortgage credit product is better than another because the former offers a low interest rate. However, if it fails to show the full cost of credit, additional information will be necessary to calculate the effective rate and hence the full cost.

A further consequence is that consumers may be misled in cases where they compare different advertisements for secured and unsecured credit. In the absence of effective sectoral national rules on mortgage credit advertising, a consumer may be misled into believing that the offer for secured credit is more advantageous when, in fact, it only appears more advantageous because of the much wider discretion that creditors have concerning what information to include, omit, emphasize, or de-emphasize in mortgage credit advertising in comparison to consumer credit advertising. Even in the case where national sectoral rules on mortgage credit advertising exist, the problem of comparability still remains. The requirements of these rules (i.e. on what information must be included, information triggers, legibility, prominence, etc) are likely to differ from one Member State to another, leading again to the same problem: the difficulty for the consumer to objectively compare offers, and the possibility to conclude that a particular product is more advantageous than others when in fact it is not.

The current situation concerning mortgage credit advertising is therefore conducive to consumer detriment. Consumer confidence can be negatively impacted due to the difficulties in comparing offers in credit advertisements in an environment of numerous complex credit products and services and insufficient financial education. Given that, as described above, a consumer may be misled into erroneously believing that an advertised credit product is better than others or more suitable for him, consumers may end up purchasing inappropriate products and suffer financial detriment. This could, in a worst case scenario, lead to a rise in overindebtedness, defaults, and foreclosures/repossessions, all of which can pose a risk to financial stability. Customer mobility is also negatively affected; the difficulty of comparing different credit products advertised and its negative effect on consumer confidence feeds people’s domestic bias and leads to even less confidence in cross-border shopping of credit products and services. Finally, cross-border business is also likely to be negatively impacted since creditors may face additional costs to adapt advertising materials. In addition, a foreign credit product which is better and cheaper than a domestic may not be able to have its merits effectively promoted through advertising, especially in those Member States where no sector-specific rules for mortgage credit advertising exist. This negative effect on the cross-border activity of consumers and businesses is inherently damaging to the creation of a single market.

1.3.3. *Inconsistencies and gaps in the rules covering the marketing and advertising of mortgage credit*

While Community rules have already been introduced to prevent misleading advertising, regulatory gaps still remain. The Directive on Unfair Commercial Practices[252] includes a general prohibition on misleading and aggressive commercial practices, but no specific rules that would facilitate comparability of advertised credit offers, such as requirements to include specific information in a particular way (i.e. information triggers[253] and/or a standard set of information). As already discussed above, specific sectoral rules have been introduced under the CCD[254] to address the gap in coverage in relation to consumer credit. However, a substantial gap remains, and it relates to the fact that mortgage credit advertising is neither subject to specific sectoral Community rules nor to specific sectoral national rules in many Member States. This results therefore in a situation where specific sectoral legislation ensures a high level of consumer protection concerning credit marketing and advertising practices, but only when these practices relate to consumer credit from EUR 200 to EUR 75 000. When these practices relate to secured (mortgage) credit or credit of more than EUR 75 000, CCD rules do not apply and consumers are not afforded the same level of protection.

Not only does this mean that advertising and marketing materials across Europe remain non-comparable for those consumers wishing to shop around, but those lenders and/or credit intermediaries offering products and services cross-border face a dual or multiple burden. Furthermore, the consumer is unlikely to understand that the advertiser is much less restricted regarding the information to include in the advert for mortgage credit than that for consumer credit. He is likely to be confused into believing that he is afforded the same level of protection in respect of advertising of all types of credits, and thus potentially be misled by mortgage advertising that appears attractive and advantageous. Given the importance of a mortgage credit compared to a consumer credit, both in terms of the value and significance of taking out a mortgage credit, as well as the long term nature of a mortgage credit, the fact that consumers are afforded a higher level of protection for consumer credit advertising than mortgage credit advertising is in itself misleading consumers about the importance of the decision at stake.

The current situation at Community level that discriminates between consumer and mortgage credit, as well as the differences observed in Member States in respect to credit advertising, are a cause for concern. They are likely to confuse consumers regarding their rights (i.e. when more restrictions apply to consumer credit advertising than in mortgage credit) and reduce consumer confidence; they can negatively impact cross-border customer mobility; and they can impede cross-border business since creditors may have to adapt marketing and advertising practices/IT tools/rulebooks/training to comply with, for example, different requirements of sectoral legislation in another Member State. This negative effect on the cross-border activity of consumers and businesses are potentially damaging to the creation of a single market.

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252 See footnote 235.

253 Information triggers means that certain specified pieces of information, if included in an advertisement, must be accompanied by other specified pieces of information.

254 *Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC,* OJ L 133, 22.5.2008, pp. 66-92.

1.3.4. *Summary of problems and consequences*

Table 1: Problems and consequences

Specific problems and their drivers	Consequences
Non-comparable, unbalanced, incomplete and unclear advertising and marketing – unbalanced, unclear or incomplete advertising and marketing – lack of EU-wide comparability of advertising and marketing materials – inconsistencies and gaps in the rules covering the marketing and advertising of mortgage credit	For consumers: **Risk of consumer detriment & reduced customer mobility** – information asymmetries increase and consumers find it harder to make informed assessments and judgements – non-transparent, non-comparable pricing may prevent realisation of lower prices – difficult to compare offers consumers may purchase inappropriate or unnecessary product => consumers purchase a credit product which is inappropriate for them or unnecessary => risk of inability to keep up with payments => risk of overindebtedness and foreclosure on home => reduced consumer confidence => if practices are widespread, risks of financial and economic stability **Low cross-border activity & missed business opportunities** – dual or multiple burdens caused by different national rules on mortgage advertising – difficult to compete on product merit/price in the absence of specific rules that restrict unfair/unbalanced advertising => missed opportunities for cross-border business => restricted competition in the single market

1.4. Stakeholder views

The following stakeholder views were provided to the Commission in the context of a public consultation on responsible lending and borrowing of July–September 2009[255].

1.4.1. *Consumers*

The great majority of consumer organisations reported problems of inappropriate, unfair, or misleading advertising practices that occurred with regard to both consumer and mortgage credit and were generally performed by credit institutions. Most consumer representatives expressed their concern over the observed unfair advertising practices and their impact.

1.4.2. *Financial services industry*

This group of stakeholders in general indicated that such practices do not occur, stating that as the financial services industry abides by the legislation. They stated that there are low levels of complaints regarding unfair practices reported to regulators. Furthermore, according to the financial services industry, the Unfair Commercial Practices Directive and CCD are sufficient and there is no need for further binding legislation. According to these stakeholders, national law already effectively regulates misleading and unfair practices. Instead they highlighted the need to focus on the enforcement of existing rules.

1.4.3. *Member States*

Member State authorities' responses demonstrated differing views. UK authorities stated that there is no widespread evidence of misleading marketing and advertising practices, and that

255 http://ec.europa.eu/internal_market/finservices-retail/credit/responsible_lending_en.htm

the existing regulatory framework is appropriate to address these practices. The UK Treasury indicated that routine monitoring of advertising has led to some firms having to change their advertising approach. However, German, Latvian, French, Polish, Irish and Belgian authorities mentioned that banks still perform unfair and misleading practices such as 'bait advertising' and failure to include warning statements in a larger font size than the normal font size used in the advertisement. The German and Dutch authorities set out the regulatory responses that have been, and are being, undertaken to address these problems at the national level.

1.5. Objectives

1.5.1. General objectives

– To create an efficient and competitive Single Market with a high level of consumer protection by fostering:

  – consumer confidence;

  – customer mobility;

  – cross-border activity of creditors and credit intermediaries;

  – a level playing field.

– Promote financial stability throughout the EU by ensuring that mortgage credit markets operate in a responsible manner.

1.5.2. Specific objectives

– Ensure that mortgage advertisements are balanced, complete, clear and allow comparability of products.

1.5.3. Operational objectives

– Ensure that mortgage advertisements contain clear, complete, and balanced information.

– Ensure that mortgage advertisements are presented in a way that enables objective comparison of different offers.

– Ensure that customers shopping cross-border and operators wishing to offer their services cross-border are not being burdened by inconsistent regulation.

1.6. Description of policy options

1.6.1. Option 1: Do nothing

Doing nothing would mean that all the problems identified above remain.

1.6.2. Option 2: Application of Article 4 of the CCD

Rules could be introduced which would oblige all parties engaged in mortgage credit marketing and advertising communications to comply with requirements in respect to their form and content. These requirements could be similar to the ones contained in the CCD[256]. By introducing similar requirements to those contained in the CCD, three categories of requirements would be introduced.

– Information triggers: A marketing/advertising communication that includes any of a pre-defined list of information triggers the inclusion of other information. For example, any indication of an interest rate or the cost of credit triggers the inclusion of other information, such as the Annual Percentage Rate of Charge.

– Combined/standard information: A number of pieces of information must be presented together as a whole. For example, if an information trigger is activated, it is compulsory that a group of other pre-defined types of information be included also, all together as a whole.

– Clarity, conciseness, prominence, representative example: When the combined/standard information must be included, it should be specified in a clear, concise, and prominent way by means of a representative example.

Article 21 of the CCD also requires that credit intermediaries indicate in advertising whether they are tied or independent agents. An initiative for mortgage credit could contain provisions for all of the above requirements.

1.6.3. Option 3: Specific rules on the format and content

Rules could be proposed to ensure that all parties engaged in mortgage credit marketing and advertising communications comply with specific detailed requirements with respect to their form and content. One way to go about this is to outline the requirements of the CCD[257] and then indicate what sort of requirements should be added, removed, or amended. These requirements could, in particular, consist of some or all of the elements contained in the box below. To take account of developments in financial markets and to ensure uniform application, implementing measures may also be considered in the event that a legislative instrument is chosen.

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256 For the specific provisions of Article 4 of the Directive, see section 'Current situation'/'Community level'.

257 See footnote 256.

To specify that the credit is a mortgage credit, which, if applicable, requires a security (= mortgage).

Comparability: Indications in advertisements that can communicate the idea that the terms of the advertised product are more advantageous than those of competing products should trigger inclusion of the APRC or the standard set of information[258].

Incentives: Advertisements that offer incentives such as gifts, discounts, or other special offers should trigger inclusion of the APRC or the standard set of information[259].

Unconditional access to credit: Advertisements that indicate that mortgage credit is available to anyone should trigger inclusion of the APRC or the standard set of information[260].

The APRC figure: the APRC advertised should not be the lowest possible that would probably be unavailable to the majority of consumers, but perhaps one that would be reasonably expected to be granted to a large majority of consumers.

The APRC range: Rules applicable when using a 'from' APRC x% 'to' APRC y%.

A list of prohibited expressions that will be regularly updated, such as 'zero interest loans'.

Requirement to include warnings pointing to a risk of losing the home, if applicable, and specific warnings triggered when the rate is variable or the loan is denominated in foreign currency.

Prominence: Requirements that ensure that the most important information receives the greatest prominence. In particular, 'APRC x%' should be more prominent than most or all other pieces of information; risk warnings should be substantially prominent and definitely not less prominent that some other information such as a borrowing rate. The set of standard information should also be no less prominent that some other information such as a borrowing rate.

Requirement to communicate information in plain and intelligible language that is easily visible/legible and/or audible depending on the medium used.

Name of the advertiser (Registered business name)

Medium-specific:

Rules concerning air time/audibility/legibility of particular pieces of information (TV, Radio)

Rules concerning 'cold calls', unsolicited mail, and 'door-to-door' marketing

Rules concerning pop-up banners on internet websites and way of presenting information on websites

Rules concerning font size for SMS and print media communications.

1.7. Policy instruments

Each of the above options could be given effect through a variety of different policy instruments. These include an industry self-regulation (Code of Conduct), Community level non-binding measures such as a Recommendation or Communication, or binding Community measures such as Community legislation in the form of a Regulation or Directive. Table 2

258 It is assumed here that the standard set of information includes the APRC.
259 See footnote 258.
260 See footnote 258.

explores the feasibility of giving effect to each of our policy options through each of the available policy instruments:

Table 2: Advertising and marketing – Policy options versus instrument

Options	Self-regulation	Communication	Recommendation	Directive	Regulation
1: Do nothing					
2: Application of Article 4 of the CCD	X		X	X	X
3: Specific rules on the format and content	X		X	X	X

A Commission Communication would be unable to achieve any of the objectives as it is a tool to communicate information to the Member States rather than effect a particular change in the way things are done. The following sections will assess the impact of the policy options and will describe which policy instrument is the most appropriate to use, as well as the underlying reasons for the choice.

1.8. Assessment of policy options

1.8.1. Option 1: Do nothing

1.8.1.1. Effectiveness of policy option

Doing nothing would mean that all the problems identified above remain.

1.8.1.2. Impacts of policy option on stakeholders and efficiency

The risk that consumers are misled by advertising and marketing communications that are not clear, balanced and complete will remain, and consumers will continue to face difficulties in making informed assessments and comparisons of the products marketed to them. The resulting negative impact on consumer confidence and the risk of consumer detriment will remain unaddressed. The risk to financial stability, which flows from consumer detriment, will also therefore remain unaddressed. Intra-state and cross-border customer mobility, two main drivers of which are product comparability and consumer confidence, will also be negatively impacted in the 'No action' scenario.

Furthermore, the risk of providers engaging in regulatory arbitrage between consumer credit and mortgage credit advertising rules will also remain unaddressed[261]. Nonetheless, the possible extension by a number of Member States[262] of the CCD provisions on advertising to mortgage credit would mitigate the abovementioned negative effects, albeit to a limited extent. This is because about a third of the Member States do not apply or intend to apply the CCD rules on advertising to mortgage credit.

[261] Given the existing sector-specific Community rules on consumer credit and their absence thereof for mortgage credit, the advertiser is much less restricted in the information he/she includes in the advert for mortgage credit than that which he/she includes in adverts for consumer credit. The advertiser may therefore be motivated to engage in regulatory arbitrage.

[262] The following 18 countries are extending some or all the advertising provisions of the Consumer Credit Directive to mortgage credit: Bulgaria, Denmark, Germany, Estonia, Italy, Cyprus, Latvia, Hungary, Malta, the Netherlands, Austria, Portugal, Romania, Slovenia, Slovakia, Finland, Sweden and the United Kingdom.

With respect to creditors and credit intermediaries, on the one hand it is expected that maintaining the status quo will deprive them of opportunities for cross-border business, since the obstacles caused by diverging national laws will remain. Competition will therefore be restricted. On the other hand, providers will not have to bear any costs for adapting their practices to comply with new advertising rules, nor will the discretion that they are currently afforded in respect to the format and content of their advertisements change.

As far as Member States are concerned, while there will not be any costs associated with introducing and enforcing any new rules, there will however be a large cost to society associated with the unaddressed risk of consumers who get misled, suffer detriment and, in the worst case scenario, become overindebted, default, and lose their home. It follows that doing nothing would be detrimental to the overall economic and social stability and cohesion.

1.8.2. Option 2: Application of Article 4 of the CCD

1.8.2.1. Effectiveness of policy option

On the one hand, the introduction of standards similar to those contained in Article 4 of the CCD would lead to an improvement with respect to the issue of clarity, balance, completeness and comparability of mortgage credit advertising. This effect would have a positive impact on customer mobility and on consumer confidence, particularly for more vulnerable consumers such as those with lower levels of financial literacy or on low incomes. Applying the CCD provisions to mortgage credit would also be very effective in reducing the potential scope for regulatory arbitrage between consumer and mortgage credit advertising rules. Furthermore, applying the CCD to mortgage credit would facilitate cross-border business to some extent by removing obstacles caused by diverging national laws, thus enabling economies of scale and scope for advertising and marketing materials.

On the other hand, such rules are likely to fall short of ensuring a sufficiently high level of protection for consumers; given the particularities, importance, and effects of mortgage credit on consumers (very large amount, very long financial commitment, high instalments, family home as collateral, etc). A sufficiently high level of protection may not therefore be adequately achieved through the introduction of rules that are identical to those contained in the CCD which are designed for consumer credit rather than for mortgage credit.

The strength of all the above effects will, of course, depend on the policy instrument chosen.

1.8.2.2. Impacts of policy option on stakeholders and efficiency

Consumers and society at large are expected to benefit through the greater clarity, balance, completeness and comparability of mortgage advertisements. This will reduce the likelihood that consumers, particularly those with lower levels of financial literacy, are misled and end up purchasing inappropriate products, and thus suffer detriment through increased overindebtedness and eventually defaults and/or foreclosures. The benefits to society from a reduced number of defaults are estimated at between EUR 21–41 million. In case the instrument is self-regulation or recommendation, the benefit will most likely lie at around the lower end of the aforementioned value range. This is because universal agreement and adherence is difficult to implement, enforce, and supervise, and also because binding national rules may prevent adherence to the non-binding instrument.[263] Consumers will also benefit

[263] See assessment of policy instruments section below.

from the increased comparability of mortgage advertising and marketing materials. Being able to compare advertisements more easily will facilitate customer mobility by reducing search costs and encourage consumers to look around for a better deal, both domestically and cross-border. This in turn could deliver tangible benefits in the form of a better deal through the resulting impact on competition.

With respect to creditors and credit intermediaries of mortgage products and services, it is expected that this option will have both positive and negative economic impacts. The former will mainly come from opportunities for cross-border business resulting from similarity in national practices as well as a more level playing field. The negative impact will result mainly from one-off costs for training and adaptation of systems or manuals. These costs are expected to amount to approximately EUR 17 million. No incremental annual recurring costs are expected as both creditors and credit intermediaries already face compliance costs for existing rules on advertising and marketing, e.g. Directive on Unfair Commercial Practices[264] or national rules on advertising and marketing. Consequently, there are unlikely to be incremental costs in terms of compliance monitoring.

Impacts on Member States' administrations are also likely to be limited. It is expected that this option would have some financial impact, but only in case there would be costs relating to transposition of legislation[265]. It is expected that Member States will incur one-off costs of about EUR 0.21 million. Member States are unlikely to face incremental costs in monitoring and enforcing rules on advertising and marketing since rules already exist and compliance with them is already monitored. Member States would also face lower costs because reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. as fewer consumers may lose their homes.

1.8.2.3. Quantification of costs and benefits

Consumers and society in general will face an aggregate benefit of EUR 21–41 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 0.5–1 basis points due to the consumer receiving appropriate advertising and marketing materials which will enable them to select a more appropriate product for their needs.

– This is equivalent to mortgages of EUR 62–125 million[266].

– These benefits are however discounted by 67 % to reflect the fact that 18 Member States[267] already apply the CCD to mortgage credit.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[268].

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264 Directive on Unfair Commercial Practices.

265 See assessment of policy instruments section below.

266 EU gross residential mortgage debt in 2007 stood at EUR 1 244 966 billion. See footnote 1.

267 See footnote 262.

268 This is because self-regulation or recommendation are likely not to achieve levels of compliance approaching 100 %; some regulators may decline to apply the recommendation, while some providers

Consumers will also benefit in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to creditors and credit intermediaries in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face EUR 17 million in costs. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[269]. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 17 million. This is based on the assumption that 30 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[270] This is also based on the assumption that adaptation of information technology systems and standard operating procedures requires 4 man days per credit institution and 4 man days per credit intermediary.[271]

– It is assumed that in this instance, providers will not face any incremental annual recurring costs (e.g. compliance costs) because providers already have to ensure compliance with existing rules on advertising and marketing (e.g. Directive on Unfair Commercial Practices and/or national rules on mortgage advertising). As such there will not be any incremental costs for ensuring compliance with new rules.

– These costs reflect the fact that the total amounts have been discounted by 67% to reflect the fact that 18 Member States[272] already apply the CCD to mortgage credit.

Member States will face EUR 0.21 million in costs in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.21 million. This is based on the assumption in a recent study[273] that each Member State will incur one-off costs of approximately EUR 23 529. The fact that 18 Member States[274] already apply the CCD to mortgage credit means that only the nine Member States will face costs.

– It is assumed that Member States will not face any incremental annual recurring costs for monitoring and enforcing the rules because they already have to ensure compliance with existing rules on advertising and marketing (e.g. Directive on Unfair Commercial Practices and/or national rules on mortgage advertising). As such there will not be any incremental costs for ensuring compliance with new rules.

may refuse to sign up to the self-regulatory instrument or avoid applying it to its full extent. See the assessment of policy instruments section below.

269 See footnote 268.

270 This 30/80 % assumption is based on the fact that credit institutions have much more staff than credit intermediaries, the latter often being an entity of 3–4 people.

271 The 90-hour and 30-hour figures are Commission services' estimates of the time needed for the particular task. In Option 3, these figures are higher because of the greater complexity, specificity, and coverage of the rules proposed.

272 See footnote 262.

273 See footnote 136.

274 See footnote 262.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

1.8.3. Option 3: Specific rules on the format and content

1.8.3.1. Effectiveness of policy option

The introduction of specific rules on mortgage credit advertising and marketing would oblige all parties (or a large number in case the rules are consisted in self-regulation or recommendation[275]) engaged in mortgage credit marketing and advertising communications to comply with detailed requirements in respect to their form and content (such as those described above). This is expected to be very effective in achieving clarity, fairness, balance, and comparability of mortgage credit advertising. This is primarily due to the fact that the requirements could be tailored to reflect the specificities of mortgage credit. This will prevent any scope for confusing or misinforming the potential customer, particularly consumers with low levels of financial literacy or other vulnerable groups (e.g. low incomes) by advertising, for example, an annual percentage rate of charge that is not their typical one but rather the lowest one that is offered to a small fraction of their customers or that is only available if the consumer purchases a series of other products. As such, this policy option will significantly reduce the risk of misleading mortgage advertising, thus facilitate consumer understanding as well as the ability to compare and make informed choices. This effect would have a positive impact on consumer confidence as well as customer mobility. Furthermore, by adapting the rules to take into account the specificities of mortgage credit, it will be particularly able to achieve the high level of protection that consumers need in relation to mortgage credit advertising. This would limit consumer detriment by enhancing consumer confidence and preventing overindebtedness, potentially leading to default and foreclosure.

Market integration will also be effectively promoted through this option; the detailed rules will create a level playing field across Europe which will facilitate cross-border activity of both businesses and consumers as well as offering opportunities to creditors and credit intermediaries for economies of scale and scope. Businesses will not be faced with obstacles caused by diverging rules and consumers will be subject to the same high level of protection. This option will also minimise, albeit not to the same extent as the previous policy option, the scope for regulatory arbitrage between consumer and mortgage credit advertising rules.

The strength of all the above effects will, of course, depend on the policy instrument chosen.

1.8.3.2. Impacts of policy option on stakeholders and efficiency

It follows that the economic and social impacts on consumers under this option are particularly beneficial and clearly greater than in the previous option: the ability of consumers to understand and compare advertised products and services would substantially improve, their confidence will rise as a result of the higher level of protection and tailor-made rules for mortgage advertising, and the likelihood of being misled and suffering financial detriment due to advertising will become negligible. This has obvious positive economic and social impacts for financial stability and society as a whole, as it reduces the likelihood of overindebtedness, defaults, repossessions and their associated suffering and social disapproval and unrest. Such

[275] See footnote 268.

an outcome constitutes a positive social impact. This is because of the greater reduction in the likelihood of overindebtedness, defaults and repossessions. The potential benefits to society arising from reduced defaults are estimated at between EUR 124–187 million. In case the instrument is self-regulation or recommendation, the benefit will most likely lie at around the lower end of the aforementioned value range[276]. Consumers will also benefit from the increased comparability of mortgage advertising and marketing materials. Being able to compare mortgage advertisements more easily will facilitate customer mobility by reducing search costs and encourage consumers to look around for a better deal, both domestically and cross-border. This option would however have less of an impact than the previous one in terms of improving the comparability of mortgage and consumer credit, for those consumers, for example seeking a loan to renovate a property. The increased benefits in terms of understandability and comparability in turn could deliver tangible benefits in the form of a better deal through the resulting impact on competition.

With respect to creditors and credit intermediaries, it is expected that this option will have both positive and negative economic impacts. This option would as equally effective as the previous option in promoting opportunities for cross-border business resulting from an approximation of the advertising rules in the Member States. More comparable mortgage advertising materials could also attract more clients thus offering concrete business opportunities through increased competition. However, creditors and credit intermediaries would also face one-off costs for training and revising tools and advertising practices amounting to approximately EUR 51 million. These costs are substantially higher than under the previous policy option due to the fact that creditors and credit intermediaries in all Member States would have to adapt to the new rules. Furthermore, the detailed and prescriptive requirements will substantially reduce the margin of discretion concerning the format and content of their advertising/marketing communications. This latter impact will reduce the ability of providers to rely on creative and inventive advertising/marketing to attract customers, which perhaps means that certain providers who had no cost or product advantage but still attracted customers thanks to very successful advertising/marketing techniques could be particularly hit.

All Member States' administrations will face costs for introducing legislation in the event of a legislative instrument being chosen. It is estimated that Member States will incur one-off costs of about EUR 0.64 million. Member States are unlikely to face incremental annual recurring costs as they already are responsible for supervising the enforcement of laws on advertising and marketing. Member States would also face lower costs because reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes.

1.8.3.3. Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 124–187 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 1–1.5 basis points due to the consumer

[276] See footnote 268.

receiving appropriate advertising and marketing materials which will enable them to select a more appropriate product for their needs.

– This is equivalent to mortgages of EUR 124–187 million[277].

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[278].

Consumers will also benefit in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face EUR 51 million in costs. These costs can be broken down as follows.

– One-off costs are estimated at approximately EUR 51 million for establishment of new schemes, the development of new standard operating procedures and staff training. This is based on the assumption that 30 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[279] It is also based on the assumption that adaption of procedures and IT systems will take 4 man days per credit institution and per credit intermediary.

– It is also assumed that in this instance, providers will not face any incremental annual recurring costs (e.g. compliance costs) because providers already have to ensure compliance with existing rules on advertising and marketing (e.g. Directive on Unfair Commercial Practices and/or national rules on mortgage advertising). As such there will not be any incremental costs for ensuring compliance with new rules.

Member States will face EUR 0.64 million in costs in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[280] that each Member State will incur one-off costs of EUR 23 529. In this instance, all Member States would have to modify their legal framework for advertising and marketing albeit to varying degrees.

– It is assumed that Member States will not face any incremental annual recurring costs for monitoring and enforcing the rules because they already have to ensure compliance with existing rules on advertising and marketing (e.g. Directive on Unfair Commercial Practices and/or national rules on mortgage advertising). As such there will not be any incremental costs for ensuring compliance with new rules.

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[277] EU gross residential mortgage debt in 2007 stood at EUR 1 244 966 million. See footnote 1, p. 71.

[278] See footnote 268.

[279] See footnote 270.

[280] See footnote 136.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

1.8.4. Comparison of options

The analysis of the options above clearly demonstrates that the objectives of this initiative cannot be achieved under the 'Do nothing' scenario. It preserves the status quo and thus all the problems that have been identified in Section 1.3 remain. Consequently, Option 1, the 'Do nothing' scenario, does not therefore entail any financial costs or benefits.

Table 3: Advertising and marketing – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure that mortgage advertisements are balanced, complete, clear and allow comparability of products	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1: Do nothing	0	0	0	0	0	0	0
2: Application of Article 4 of the CCD	✓	✓	✓	✓	✓	✓	✓
3: Specific rules on the format and content	✓✓	✓✓	✓	✓	✓	✓✓	✓✓

Contribution to objectives compared to the situation today
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Options 2 and 3 are considered to be equally effective in terms of promoting a level-playing field and promoting cross-border mobility; both options introduce EU-wide rules that facilitate cross-border business for creditors and credit intermediaries by enabling economies of scale and scope, as well as provide consumers with the same high level of protection thus enhancing consumer confidence. Confident consumers who are better informed are more likely to shop around for the best deal, and if necessary, switch providers. However, under Option 3, the rules would be able to take into account the specificities of mortgage credit (e.g. home used as collateral), thus further enhancing consumer understanding and confidence and reducing consumer detriment. Option 3 is therefore most effective in reducing the risk of mortgage advertising that could mislead and/or cause consumer detriment, particularly for those consumers with low levels of financial literacy and other vulnerable groups. It is thus, by implication, also the most effective in reducing risks to the overall financial and social stability of the Member States. As such, while Option 2 is effective in meeting the objectives, it is not as effective as Option 3. Option 3 is therefore most effective in ensuring comparable, balanced, complete and clear advertising and marketing materials. Finally, both options were found to be equally efficient in achieving the pursued objectives.

Table 4: Advertising and marketing – Impact on main stakeholders

Stakeholders/ Policy options on mortgage advertising & marketing	Consumers	Creditors and credit intermediaries	Member States
1: Do nothing	0	0	0
2: Application of Article 4 of the CCD	✓	×	×
3: Specific rules on the format and content	✓✓	×	×

Impact on stakeholders compared to the situation today
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Both Options 2 and 3 offer benefits to society as a whole and consumers in particular in the form of reduced levels of default. The benefits of Option 3 are however expected to be higher because of the greater impact on the level of defaults. This impact arises primarily from the fact that the requirements under Option 3 are more customised to the specificities of mortgage credit and thus have a greater impact on consumer confidence and understandability.

Options 2 and 3 both entail costs for creditors and credit intermediaries, as well as Member States (in case of a legislative instrument). For these stakeholders, the costs associated with Option 3 are higher than for Option 2. This is due to the fact that 18 Member States already intent to apply Option 2 whereas all 27 Member States would have introduce new rules and alter systems under Option 3. It is assumed however that in the case of Member States, the costs of introducing new legislation would be offset by the aforementioned benefits for society. Additionally, in theory, with lower foreclosures, Member States would face lower costs in terms of necessity of providing social housing, etc. for those consumers who lose their homes.

Table 5: Advertising and marketing – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 1	Option 2	Option 3
Consumer/social benefits: reduction in defaults (value of mortgages)[281] increased customer mobility **Creditor/credit intermediary benefits:** efficiency savings	0 0 0	21–41 Not quantifiable Not quantifiable	124–187 Not quantifiable Not quantifiable
Total EU costs (million EUR)	Option 1	Option 2	Option 3
Creditor/credit intermediary costs: one–off recurring **Member State costs:** one–off recurring	0 0 0 0	17 0 0.2 0	51 0 0.6 0

Note: In the event of self-regulation or a Recommendation, the costs or benefits would lie at the lower end of the ranges provided, except for Member States where the value would become zero.

In conclusion, Option 3 would be the most effective in achieving the objectives pursued, while taking also into account its impact in terms of costs and benefits to stakeholders.

281 It is noted that while costs directly reduce providers' revenues, the benefits termed 'reduction in defaults' are not revenues; they are assets that are expected to generate revenues in the form of interest received.

1.9. Assessment of policy instruments

1.9.1. Self-regulation

The preferred option could be pursued through the use of self-regulation. One of the stated benefits of self-regulation is that it is quick, flexible and may easily be modified to take into account market developments. Choosing self-regulation would represent an important signal as to the future credibility of this instrument in the field of retail financial services. It should be underscored however, that negotiations between the mortgage industry and consumer representatives are likely to be extremely difficult, long, and resource consuming, due to the large divergence of opinions between the two parties on this issue. Given their shortage of resources, this problem is likely to be particularly acute for consumer representatives. A major concern is that a major part of the benefits of self-regulation become neutralised due to the aforementioned potential problems.

For self-regulation to be successful, adherence and implementation of the agreed code of conduct must be particularly high, near the 100 % level that exists in the case of binding legislation. Given the Commission's experience with the adherence and implementation of the *Voluntary Code of Conduct on Pre-Contractual Information for Home Loans* which is implemented to varying degrees in 20 Member States[282], it is believed that it is unlikely to achieve adherence and implementation levels approximating 100 % across the EU. This is because some providers may refrain from signing a Code, while others may be unable to do so for fear of contravening national legislation, and others may sign but inadequately apply it. It is therefore unlikely that self-regulation will be an effective instrument in the achievement of the objectives identified.

1.9.2. Non-binding Community instrument

A Commission Recommendation to Member States for the introduction of specific rules on mortgage advertising and marketing communications is unlikely to be effective in improving the clarity, fairness, balance and comparability of mortgage credit advertising across the EU. This is because some Member States are likely to refrain from implementing the recommendation into national law while others may be prevented by the existence of contravening national provisions and be reluctant to amend and/or abolish existing national provisions. It therefore follows that implementation is unlikely to reach at or near the 100 % level. This will result in a somewhat partial achievement of the objectives pursued, with the extent of success largely dependent on how many Member States would decide to implement the Recommendation.

1.9.3. Binding Community instrument

The introduction of binding community instrument is expected to be more effective in ensuring clarity, fairness, balance and comparability of mortgage credit advertising across the EU. Only a binding Community instrument can guarantee that the preferred specific advertising rules are introduced in every Member State and should be adequately enforced

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282 *European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans: Third Progress Report on Implementation in the European Union*, European Banking Industry Committee, April 2009, http://www.eubic.org/Position%20papers/3rd%20EBIC%20Progress%20Report%20on%20the%20Implementation%20of%20the%20Code%20of%20Conduct%20on%20Home%20Loans.pdf.

through regulatory oversight and dissuasive sanctions for non-compliance. In contrast to the other instruments discussed, binding legislation should ensure 100 % adherence and implementation. Non-compliance would mean a contravention of the law. Thus a binding instrument would ensure a level playing field that promotes the mobility of businesses, consumer confidence and consumer mobility through the provision of clear, complete and balanced information that are comparable across the EU, and thus contribute to creating a competitive and efficient Single Market for mortgage credit.

Adopting binding legislation is however particularly time consuming and costly. Member State administrations will incur costs for implementation, transposition (in case of a Directive) and enforcement. Creditors and credit intermediaries will incur costs for changing systems, standard operating procedures, and for employee training. These costs however are mitigated, albeit to a limited extent, by the cost savings achieved by those providers engaged in cross-border business; the level playing field will allow them to avoid duplication and save from operational optimisation. It should be noted however, that while binding legislation involves certain costs, self-regulation and a recommendation would also involve very similar costs if anywhere near the 100 % level of adherence and implementation would be reached; creditors and credit intermediaries will again have to incur costs for training and changing procedures and practices, albeit smaller given the likelihood of falling short of the 100 % level.

In general, the Commission has the choice between a Directive and a Regulation as a binding policy instrument. A Directive has, on the one hand, the advantage of allowing for a more flexible approach, enabling both minimum and maximum harmonisation within the same instrument and thus is able to take into account the specificities of national markets. A minimum harmonisation Directive would allow more flexibility to Member States than a maximum harmonisation Directive, which would reduce the possibilities for Member States to gold plate. A Regulation, on the other hand, theoretically allows achieving the highest level of harmonisation and standardisation in a shorter timeframe without the need for national transposition measures. It also enables private enforcement by consumers and business alike, thus bringing the single market closer to the citizen.

Introducing specific advertising rules tailored for mortgage credit such as the ones described above (section 'Description of options') implies a high level of standardisation, and thus a Regulation may be more suitable. A Directive however would also be suitable; while the preferred option consists of numerous specific rules, there is still a margin of discretion left to Member States to decide the means for achieving the specific results. While a Directive approach with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national specificities of the market. A Directive could also, in theory, ensure maximum harmonisation in certain areas, while enabling minimum harmonisation in others. Such an approach would provide a degree of flexibility. It is therefore recommended to use the legal instrument of a Directive in respect to the issue of mortgage advertising and marketing communications.

1.10. Impact on Community resources and impacts on third countries

The preferred policy option on mortgage advertising does not have any impact on European Community resources.

Positive social impacts can be expected under this option. The option operates to substantially improve the clarity, fairness, and comparability of mortgage advertising, so that consumers are better informed, better aware, more able to compare, and less likely to be misled and suffer detriment. This reduces the likelihood that consumers end up with unsuitable and/or unsustainable products that can cause overindebtedness and defaults. It follows that the estimated reduction in defaults under this option confers an important social benefit to European consumers.

No impact on the environment can be expected from the policy proposals.

With regard to impact on third countries, the introduction of advertising and marketing rules will not lead to any discrimination vis-à-vis third countries offering their services in the EU. If the proposed Directive is extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway.

1.11. Conclusion

The introduction of specific rules on mortgage advertising is expected to address effectively the problems identified and generate positive impacts on the EU mortgage market. Consumers will be confronted with clear, fair, and comparable marketing communications, and businesses will be subject to the same rules across the EU. It follows that, on the one hand, consumers will likely grow more confident, be less hesitant to enter into transactions, make better product choices, and increase their mobility. On the other hand, businesses will benefit from opportunities for cross-border business and operational optimisation. It was found that these results would be best achieved through binding Community legislation, rather than through a non-binding Community instrument or industry self-regulation.

2. PRE-CONTRACTUAL INFORMATION

2.1. Context

The provision of pre-contractual information[283] is crucial because it enables the consumer to understand the features and risks connected with a certain mortgage product and consequently to use this knowledge to compare this product with other products to make an informed choice. This information also needs to be presented in a way which is easy to understand and has to be given at a time which enables the consumer to use the information to compare the offers available on the market, to assess the implications of the product considered and to take a decision.

While the importance of consumers who are sufficiently financially literate to understand the information given to them has been identified earlier[284], the issue of financial education is being examined in a separate initiative by the Commission.[285]

283 Information is a description of a given product, either in general terms (objective information) or in a more specific way (specific information). It has to be carefully distinguished from other concepts such as 'advice', where the lender recommends a given product to the consumer. See *Final Report of the Mortgage Industry and Consumer Dialogue*, 20.12.2006, p. 6, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/miceg/final_report-en.pdf.

284 *White Paper on the Integration of EU Mortgage Credit Markets*, Annex 3, COM(2007) 1683/4.

2.2. Overview of the legislative framework

2.2.1. Pre-contractual information requirements

2.2.1.1. EU level

Depending on their legal traditions, Member States have either specific statutory laws or Codes of Conduct covering information obligations for mortgage credit. In addition, pre-contractual information on mortgage credit is covered by the pan-European *Voluntary Code of Conduct on Pre-contractual Information for Home Loans* (the Code), which was negotiated between European consumer associations[286] and the European mortgage lending industry[287] in 2001.[288] The objective of this Code was to introduce transparent and comparable pre-contractual information for consumers looking for mortgage loans. Under the Code, consumers are entitled to receive general information and a personalised European Standardised Information Sheet (ESIS) before the conclusion of a contract.

The agreement on the Code[289] foresaw two monitoring mechanisms. First, the European Credit Sector Associations agreed to publish an annual progress report on the implementation of the Code. Second, the Commission agreed to monitor the uptake and effectiveness of the Code and to review the operation of the Code within two years of its Recommendation on pre-contractual information to be given to consumers by mortgage lenders offering home loans.[290]

A review of the implementation of the Code, accordingly commissioned by the Commission in 2003, indicated that implementation, at that time, was unsatisfactory.[291] The European mortgage lending industry disagreed with the findings arguing that it had been carried out too early and that the methodology used was questionable.[292]

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285 The Commission has set up an Expert Group on Financial Education and has established a European Database for Financial Education (EDFE) as a new information tool on the wide range of the schemes available across the EU. See for further information http://ec.europa.eu/internal_market/finservices-retail/capability/index_en.htm.

286 The European Consumers' Organisation (BEUC), Confédération des Organisations Familiales de la Communauté Européenne (COFACE), Institut Européen Interrégional de la Consommation (IEIC), Association of European Consumers (AEC), European Community of Consumer Cooperatives (Euro Coop).

287 European Banking Federation (EBF), European Savings Banks Group (ESBG), European Association of Cooperative Banks (EACB), European Mortgage Federation (EMF), European Federation of Building Societies (EFBS), European Federation of Finance House Associations (EUROFINAS).

288 *Recommendation on pre-contractual information to be given to consumers by lenders offering home loans*, COM(2001) 477, 1.3.2001. For further information and the text of the Code see http://ec.europa.eu/internal_market/finservices-retail/home-loans/code_en.htm.

289 *European Agreement on a voluntary Code of Conduct on pre-contractual information for home loans*, May 2001, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/agreement_en.pdf.

290 http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_069/l_06920010310en00250029.pdf

291 Review of the Code of Conduct, initiated by the Commission: *Monitoring the Update and Effectiveness of the Voluntary Code of Conduct on Pre-Contractual Information for Home Loans*, Institute for Financial Services, 17.6.2003. For further information see http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/home-loans-final-report_en.pdf.

292 *Joint Industry Response to the IFF-Report on the Implementation of the Code of Conduct for Home Loans*, European banking industry, 31.10.2003. For further information see http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/response-to-iff-report_en.pdf.

The European Banking Industry Committee's third progress report published in April 2009[293] confirmed that, although adherence has improved since 2001, not all European mortgage lenders had yet adhered to the Code. Although adherence and implementation of the Code in some markets was close to 100 %[294], in other markets the situation was less satisfactory.[295] At the end of 2008, institutions representing only 45 % of the French mortgage market had implemented the Code. Furthermore, no Spanish mortgage lender has so far adhered to the Code due to incompatibility between the Code and the national legislation. In addition, although progressing, subscriptions in some of the new Member States remain limited or non-existent, e.g. in Bulgaria, Hungary, Latvia, Lithuania, Poland, Romania and Slovenia.[296]

Table 6: Legal status of and adherence to the European Code of Conduct on home loans

Country	Legal status of and adherence of the Code
Austria	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. Nor has the mortgage industry explicitly decided that lenders or mortgage credit intermediaries should respect the Code. The EBIC 3rd Implementation Report, states that almost all members of the national associations have adhered to the Code, representing 90 % of the national market.
Belgium	The mortgage lending industry decided that mortgage lenders should respect the Code immediately after the publication of the recommendation in the Official Journal of the EU. Lenders representing more than 90 % of the Belgian mortgage credit market are applying the Code. Credit intermediaries also adhere to the Code. The intermediary hands over the 'mortgage credit prospectus' of the mortgage institution(s) and the ESIS prepared by the mortgage institution(s).
Bulgaria	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. Further, the industry has not explicitly decided that lenders or credit intermediaries should respect the Code. The EBIC 3rd Implementation Report does not provide any information on Bulgaria.
Cyprus	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. However, on 15 April 2004, the industry explicitly decided that lenders should respect the Code. Seven commercial banks have signed up to this agreement. The Code does not cover credit intermediaries. The EBIC 3rd Implementation Report, states that 10 lenders have adhered to the Code and 9 have implemented it representing 58 % (in terms of loans) of the national market.
Czech Republic	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. However, the Czech Banking Association has explicitly decided that lenders should respect the Code. In 2005, the Czech Banking Association endorsed the Code on the basis of a report by the Working Group for Consumer Affairs. The Czech Banking Association invited member banks to agree to respect the CBA Standard No. 18 implementing the Code. The survey responses indicate that thirteen mortgage lenders have signed up to the Code. This is in line with findings of the EBIC 3rd Implementation Report findings, which also states that this (13 lenders) represents 78 % of the national market. The Code does not cover mortgage credit intermediaries.
Denmark	The Voluntary Code of Conduct on Home Loans is not legally binding and there are no plans to make it legally binding in the future. The Danish Mortgage Bank Association has, however, taken a decision that Mortgage Banks in Denmark should adhere to the Code. Six Mortgage Banks adhere to the Code, and this represents 94 % of the national market. The industry agreement does not cover mortgage credit intermediaries, nor does it include NCIs or regular banks.
Estonia	The Estonian Financial Supervision Authority (FSA) introduced guidelines in January 2009 for pre-contractual information that are based on the Code. The FSA monitors lenders' adherence to the Code but does not have any enforcement or sanctioning powers. 96 % of the national market (7 lenders) adheres to the voluntary Code.
Finland	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. The industry has, however, explicitly decided that lenders should respect the Code. 337 mortgage lenders in Finland adhere to the Code, which is 99 % of the national market. This is the same as that reported by the EBIC 3rd implementation report. The Code does not apply to mortgage credit intermediaries.

[293] See footnote 282.

[294] For example, Belgium (over 90 % of the market); Denmark (94 % of the market), Estonia (96 % of the market); Greece (95 % of the market); the Netherlands (99 % of the market); Austria (over 90% of the market); Portugal (95 % of the market), Slovakia (100 % of the market), Finland (99 % of the market); Sweden (90 % of the market).

[295] For example, Spain; France (45 % of the market); Cyprus (58 % of the market); Poland (0 % of the market).

[296] A register of institutions adhering to the Code of Conduct on Pre-contractual Information for Home Loans is available at http://ec.europa.eu/internal_market/finservices-retail/home-loans/code_en.htm.

France	The Code of Conduct is not legally binding in France and there are no plans to make it legally binding in the future. The mortgage lending industry has agreed to adhere to the Code, and 42 mortgage lenders in the national market adhere to the Code, representing 45 % of the national market. The Code does not, however, cover mortgage credit intermediaries.
Greece	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. The industry has explicitly decided that lenders should respect the Code, and 21 credit institutions in Greece adhere to the Code. This represents approximately 95 % of the national market. The Code does not apply to mortgage credit intermediaries.
Germany	The Code of Conduct will be transposed to German Civil Law (referred to as BGB in Germany) and the law for the introduction of the German Civil Code (EG-BGB). This will be in effect by June 2010. Currently, a large proportion of lenders in Germany have signed up to the Code. These include the members of the following industry organisations Verband Deutscher Pfandbriefbanken (vdp), Bundesverband deutscher Banken (BdB), Bundesverband Öffentlicher Banken Deutschlands (VÖB), Deutscher Sparkassen- und Giroverband (DSGV), Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), Verband der Privaten Bausparkassen (VdpB) and Landesbausparkassen (LBS). The legislation will also apply to mortgage credit intermediaries.
Hungary	The Hungarian Banking Association recommended in 2007 that its members sign up to the European voluntary Code of Conduct on Pre-contractual information. Three lenders in Hungary have signed up to the Code. The voluntary Code does not cover credit intermediaries. There are also no known plans to make the Code legally binding in the future. While the respondents to the survey did not identify this, the EBIC report states that the Hungarian Financial Supervisory Authority introduced a Recommendation in 2006 (9/2006) which integrates elements of the voluntary Code.
Ireland	The Code of Conduct is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. However, the industry has explicitly decided that lenders should respect the Code. The Irish Banking Federation (IBF) also reports that credit intermediaries respect the Code. The Irish Mortgage Council (IMC), which is affiliated to the IBF, recommended to members that the Code should be implemented and respected when it was first introduced, and the IMC continues to raise awareness of the Code. Twelve of fourteen members implement the Code fully. The exceptions are one lender (subsidiary of a UK bank) which entered the market a few years after the introduction of the Code and decided to postpone implementation in order to include any European Commission changes arising from current process and one new member that has entered the market in recent months.
Italy	The voluntary Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. Further, the industry has made no explicit decision that lenders should respect the Code. The decision over whether to respect the Code is left to the individual lender and intermediary, who will make it public by posting notices on their website and at branches. The EBIC 3rd implementation report states that 425 lenders in Italy have adhered to the Code, covering more than 79 % of the market share (in terms of branches).
Latvia	The Code is not legally binding and the government is not planning to make the Code legally binding by introducing legislation over the next few years. Further, the industry has not explicitly decided that lenders should respect the Code. According to the Ministry of Economics, just one mortgage lender in Latvia has signed up to the Code. However, there are two lenders included in the DG Internal Market and Services register, and the EBIC 3rd implementation report addendum reports that two lenders in Latvia will implement the Code by May 2010. The Code does not cover mortgage credit intermediaries.
Lithuania	The Code is not legally binding in Lithuania and there are no plans to introduce legislation or regulations to make it legally binding in the future. Further, the mortgage lending industry has not agreed to adhere to the Code. Nor, does it cover credit intermediaries.
Luxembourg	The Code is not legally binding in Luxembourg, and there are no plans to make it legally binding in the future. Further, there is no explicit agreement by industry to adhere to the Code. However, 14 credit institutions voluntarily adhere to the Code, which is approximately 90 % of the national market.
Malta	The Code of Conduct was annexed to the national Consumer Credit Regulations of 2005 and thus it is binding for all providers of mortgage credit in Malta. The ESIS included in the Code has also been integrated into the national Consumer Credit Regulations of 2005**.** The Code applies to creditors and mortgage credit intermediaries.
Netherlands	The European Code of Conduct is not legally binding and there are no plans to make it legally binding. There is a national Mortgage Code of Conduct for creditors, which includes credit intermediaries. The national Code is not the same as the European Code or the ESIS. However, the EBIC 3rd implementation report states that 131 lenders in the national market adhere to the European Code representing 99 % of the market.
Poland	The Code is not legally binding and there is no industry agreement to adhere to the Code. Currently, no Polish lenders or credit intermediaries adhere to the Code.
Portugal	The Code of Conduct has not been implemented in Portugal by any law. The Bank of Portugal issued a Circular-letter stating that the Code of Conduct had been published in the Official Journal and that the addressees should comply with such recommendation. The document in question was the Circular-letter no. 20/2001/DSB, dated the 2nd of August 2001, and made a clear reference to the addressees to observe the Commission's recommendations as exactly stated by the Commission. Two years later, the Bank of Portugal issued Instruction no. 27/2003, regarding home loans. This second Instruction reinforced the implementation of the Code of Conduct. Twenty one mortgage lenders in Portugal adhere to the Code, and this represents 94.5 % of the Portuguese national market. The Code does not apply to credit intermediaries.

Romania	The Code is not legally binding in Romania and no decision has yet been taken over whether the Code will be made legally binding over the next few years. The industry has not explicitly decided that lenders should respect the Code. The National Authority for Consumer Protection and the National Bank of Romania report that none of the mortgage lenders in Romania adhere to the Code. These organisations report that a large percentage of the Romanian financial market is held by foreign banks that do not adhere to the Code in Romania, even though (in some cases) they do adhere to the Code in their countries of origin.
Spain	No Spanish lenders or credit intermediaries have signed up to the Code. Spanish lenders that have branches abroad do however use the voluntary Code. The Spanish Mortgage Association reports that if lenders sign up to the Code, given current Spanish consumer protection law, then lenders will need to provide borrowers with two separate information sheets which increases the burden on the consumer with little or no expected benefit to either the lender or the borrower. Lenders via their national association have expressed a willingness to sign the Code once national law has been modified. As previously stated, the Association of Professional Investment and Finance Advisers (L'Associació d'Assessors d'Inversió i Finançament, AIF) in Spain has committed to encouraging the use of the Code by credit intermediaries in Spain. The Spanish Government has stated an intention to modify the consumer protection law, and included such intent in the preamble to the new law 41/2007 regulating mortgage credit.
Slovenia	The Code of Conduct is not legally binding in Slovenia and there are no known plans to make it legally binding in the near future. The industry has no formal agreement to adhere to the Code, and we believe that no mortgage lenders or mortgage credit intermediaries in Slovenia adhere to Code.
Slovakia	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. However, in January 2006, four banks which account for 61 % of the 'housing credits market' (mortgage and other consumer credit) voluntarily decided to adhere to the Code. This is a different figure from that reported in the EBIC 3rd progress report, which states that 25 lenders in Slovakia adhere to the Code representing 100 % of mortgage lenders in the national market. The EC register of adhering institutions has four lenders listed on the register. We believe that no credit intermediaries adhere to the Code.
Sweden	The Code is not legally binding and the government has no plans to make it legally binding by introducing legislation over the next few years. However, the Swedish Bankers' Association, in 2001, explicitly made the decision that mortgage lenders should respect the Code. A recommendation to apply the Code was issued by the Board of the Swedish Bankers' Association and sent to its members. 89 mortgage lenders have signed up to respect the Code, representing 90 % of the national market. The voluntary Code does apply to mortgage credit intermediaries in the Swedish market, but the number adhering to the Code is not reported.
United Kingdom	The Council for Mortgage Lenders (CML) signed the European Voluntary Code of Conduct on Pre-Contractual Information on behalf of its members in 2002. When the new Mortgage Conduct of Business regulation (MCOB) was introduced in the United Kingdom in 2004, the MCOB included requirements on pre-contractual information which are contained within the Key Facts Information (KFI) sheet. 100 % of lenders and credit intermediaries adhere to the MCOB legal requirements. The KFI is not, however, the same as the ESIS. The Financial Services Authority does however argue that the KFI goes beyond the ESIS, for example, the KFI includes the provision of important information about repayment risks. The consumer association Which? also pointed out that the KFI goes beyond the requirements of the ESIS, as did the CML. The United Kingdom is reported here as having no industry agreement to adhere to the Code. This is because the KFI is not the same as the ESIS, and as such there would be costs to the legislator and regulator of changing the current pre-contractual information, by unravelling the existing rules, and costs to the individual lenders and credit intermediaries of changing their own systems.

Source: London Economics, 2009

2.2.1.2. Member State level

Several Member States (Austria, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany[297], Latvia[298], Italy, Poland[299], Romania, Slovakia, Slovenia, Malta and Sweden) have also indicated their intention to apply to mortgage credit Article 5(1)–(4) of the CCD on the pre-contractual information to be provided to consumers. Czech Republic, Ireland, Lithuania, and Luxembourg do not intend to apply this provision to mortgage credit.

Furthermore, the CCD annex containing the Standard European Consumer Credit Information will also be applied to mortgage credit in several Member States including Austria, Belgium,

297 Partial application, the specialities of mortgage credits are taken into account.

298 Partial application, with exceptions of 5(1)(g) and (o). Application of Article 5 to mortgage credits is still under discussion.

299 Poland modified the obligations resulting from Article 5(1)–(4) CCD taking into account the specification of mortgage credit products.

Bulgaria, Cyprus, Denmark, Estonia, Latvia[300], Malta, Norway, Romania, Slovakia and Slovenia. Czech Republic, France, Germany[301], Hungary[302], Ireland, Lithuania, Luxembourg, the Netherlands and Spain do not intend to apply the article to mortgage credit. The UK mortgage rules contain prescriptive disclosure (the KFI), which they state extend beyond the SECCI or the ESIS, however second and subsequent charge mortgage lenders may use the SECCI if they choose to do so. Finland has an obligation regarding information and the SECCI is one method of fulfilling this obligation. Poland has modified the SECCI so as to take into account specifications of mortgage credit. In Sweden, the information contained in the SECCI must be given, however the form is not mandatory for mortgage credit. Italy do not as of yet know whether they will be applying the SECCI to mortgage credit.

2.2.2. Annual Percentage Rate of Charge (APRC)

2.2.2.1. EU level

One important element of pre-contractual information is the Annual Percentage Rate of Charge. The Annual Percentage Rate of Charge is the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit.[303] For mortgage credit, there is currently no European legislation harmonising the methodology for calculating the Annual Percentage Rate of Charge or the cost elements which enter into the calculation, as there is, for instance, in the field of consumer credit.[304]

2.2.2.2. Member State level

With regard to the calculation methodology, some Member States (Austria, Cyprus, Denmark, Estonia, Germany[305], Hungary, Malta, Norway, Romania, Slovenia, Spain[306] and Sweden) apply to mortgage credit the calculation method outlined in Article 19 and Annex I of the CCD.[307] However, since there is no harmonised European calculation method for mortgage credit, Member States may also apply a different methodology. Belgium, Bulgaria, Czech Republic, France, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland and Slovakia do not intend to apply this article of the CCD to mortgage credit.

Regarding the cost elements entering into the calculation, two issues should be considered when assessing which elements are taken into account: who the costs are paid to and whether they are directly related to the credit or not. A consumer has to pay a range of different costs when taking out a mortgage loan. The possible costs range from elements which are levied by the mortgage lender for his own benefit (e.g. the basic interest rate itself, commissions and other kinds of fees which the consumer has to pay in connection with the credit agreement) to cost elements, which are paid to third parties (e.g. insurance premiums, notary costs or taxes). Not all of those services in connection with the credit agreement are legally compulsory for

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300 Under discussion.

301 But German law will allow the use of a slightly modified version of the European Standardised Information Sheet ESIS.

302 Rather rules of Recommendation 2001/193/EC are mandatory.

303 See footnote 254, Article 3(i).

304 See footnote 254 which defines in Articles 3(i) and (g) what the APRC means and which cost elements are included. Furthermore, the directive lays down in Article 19 the calculation method for the APRC and in Annex I the basic equation as well as additional assumptions for the calculation.

305 Except for costs for securities.

306 See footnote 224.

307 See footnote 254.

obtaining the credit. Some costs, usually related to ancillary services such as insurance premiums or the cost of maintaining a bank account, might arise for the consumer because the mortgage lender requires the conclusion of certain services for offering the credit at a special rate. Against this background, the Annual Percentage Rate of Charge can be calculated on a narrow basis ('narrow Annual Percentage Rate of Charge'), meaning that only those costs, which are payable to the mortgage lender and levied for its interest are included, or on a wide basis ('wide Annual Percentage Rate of Charge') including other cost elements, e.g. costs which are payable to third parties.

The cost elements, which enter into the calculation base of the Annual Percentage Rate of Charge, vary between Member States. As explained above, some Member States intend to apply the definition of the APRC as set out in Article 3(g)–(i) of the CCD to mortgage credit. Other Member States, such as Bulgaria, Belgium, Czech Republic, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Slovakia and the United Kingdom have however decided against applying this article to mortgage credit. In some Member States, such as Ireland, the narrow APRC applies, meaning that only those costs, which are payable to the mortgage lender and levied for its own interest, are included in the calculation basis. In Finland the basic definition of APRC is applied to mortgage credit, but insurance costs for the real estate given as collateral are not taken into account. Other Member States require the inclusion of more cost elements in the calculation basis.

Table 7: Overview of the APRC cost base

Country	APRC
Austria	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Belgium	Narrow APRC[308]
Bulgaria	Narrow APRC but with some elements of broad[309]
Cyprus	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Czech Republic	
Denmark	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Estonia	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Finland	Narrow APRC but with some elements of broad[310]
France	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Greece	Narrow APRC[311]
Germany	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Hungary	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Ireland	Narrow APRC but with some elements of broad[312]
Italy	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Latvia	APRC not used for mortgages[313]
Lithuania	No legal specification of APRC[314]
Luxembourg	Narrow APRC but with some elements of broad[315]
Malta	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Netherlands	Narrow APRC[316]
Poland	Narrow APRC but only for mortgages up to EUR 20 000[317]
Portugal	Narrow APRC but with some elements of broad[318]
Romania	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Spain	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Slovenia	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
Slovakia	Narrow APRC (only borrowing cost are legally required buts all other costs can be included at the discretion of the lender)[319]
Sweden	Application of the definition of the APRC as set out in Article 3(g)–(i) of the CCD
United Kingdom	Narrow APRC[320]

Source: London Economics, 2009

2.2.3. Information on credit intermediaries

Information asymmetries can also exist between a credit intermediary and a consumer. Consequently, some regulation exists at both the EU and Member State level to alleviate information asymmetries between credit intermediaries and consumers.

2.2.3.1. EU level

At EU level, there is no separate requirement for the provision of information on the credit intermediary himself, on the relationship between the borrower and intermediary, or on the

308 See footnote 136.
309 See footnote 136.
310 See footnote 136.
311 See footnote 136.
312 See footnote 136.
313 See footnote 136.
314 See footnote 136.
315 See footnote 136.
316 See footnote 136.
317 See footnote 136.
318 See footnote 136.
319 See footnote 136.
320 See footnote 136.

relationship between the intermediary and the creditor(s). This contrasts with the rules governing insurance intermediaries, which are set out in detail in the Insurance Mediation Directive[321].

A requirement for disclosure of fees payable by the borrower to the intermediary is set out in the CCD[322]. However, this only covers intermediaries involved in the provision of consumer credit within the scope of the CCD and not the provision of mortgage credit[323]. The European Code of Conduct on home loans[324] does not provide for the disclosure of information on the lender-intermediary relationship.

2.2.3.2. Member State level

At the Member State level, a patchwork of regulation exists on the disclosure of the relationship between an intermediary and consumer. In eight Member States[325], a separate written contract between the borrower and the intermediary regarding the nature of terms within the contract is a requirement.[326] Austria has a comprehensive set of measures in the contract including the details of remuneration agreements between the credit intermediary and the borrower[327]. In Belgium, direct and fixed fee schemes are prohibited and credit intermediaries are not allowed to accept commission from borrowers.

Regarding the information on fees payable by consumer to credit intermediary, several Member States (Austria, Cyprus, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, Malta, the Netherlands, Norway, Poland, Portugal, Romania, Slovakia and Sweden) intend to apply the Article 21(b) & (c) of the CCD to mortgage credit. Belgium[328], Bulgaria, Czech Republic, Ireland, Lithuania, Luxembourg and Slovenia[329] do not intend to apply the article to mortgage credit. The United Kingdom has a similar provision in its mortgage rules which require the broker to state typical fees in advertising and to include them in pre-sale disclosure. In France, information concerning fees is provided for by the general dispositions of the consumer code. Spain has a similar provision in specific mortgage credit and financial intermediaries' legislation.

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321 Article 12 of the Insurance Mediation Directive stipulates that "an insurance intermediary shall provide information on his identity and address, the register in which he has been included and the means for verifying that he has been registered (…), he is under a contractual obligation to conduct insurance intermediation business exclusively with one or more insurance undertakings. In that case, at the customer's request provide the names if those insurance undertakings or he is not under a contractual obligation to conduct insurance mediation business exclusively with one or more insurance undertakings (…). In that case, he shall, at the customer's request provide the names of the insurance undertakings with which he may and does conduct business". It is further more specified that "in those cases where the information is provided solely at the customer's request, the customer shall be informed that he has the right to request such information". If the insurance intermediary holds that he provides advice based on a fair analysis, he is obliged to give advice on the basis of an analysis of a sufficiently large number of insurance contracts available on the market.

322 See footnote 254, Article 21.

323 See footnote 254, Article 21.

324 See footnote 289.

325 Czech Republic, Germany, Estonia, Malta, Austria, Portugal, Finland and the United Kingdom.

326 See footnote 6.

327 Maklergesetz (Broker Act) published in Federal Law Gazette nr 262/1996, Article 39.

328 But applies if the mortgage credit is not related to immovable property.

329 An intermediary is not allowed to request any fees.

2.3. Problem description

2.3.1. Lack of credible monitoring and enforcement mechanisms

Efforts have previously been made to address regulatory and market failures, in particular with the European Code of Conduct on home loans in 2001.[330] However, regulatory failures have made its application sub-optimal. In particular, application of the Code has been mixed and enforcement and monitoring mechanisms ineffective.[331]

Although the low level of compliance amongst several new Member States is, to a certain extent, understandable given the uncertainty on the future Commission mortgage credit policy, some EU15 markets have limited adherence and other markets have not subscribed to the Code at all.[332] In the United Kingdom, for example, the Financial Services Authority requires mortgage lenders to provider customers with a 'Key Facts Illustration', the format of which is strictly prescribed. The Financial Services Authority considers that the Key Facts Illustration meets the requirements of the European Standardised Information Sheet, albeit in a different format.[333] In Spain, no mortgage lender has subscribed to the Code due to incompatibilities between national law and the Code.[334] In France implementation of the Code is well below 100 %, while in some other countries like Italy, Ireland, Austria, and Sweden implementation of the Code is between 78 % and around 90 %.[335] As a consequence, consumers shopping around for mortgage credit offers – even domestically – may be provided with a range of information, some of which may be in line with the Code and some of which may not. In a recent survey, only 6 % of consumers reported that they had heard of the European Standardised Information Sheet for comparing offers.[336] 45 % stated that they had not received any standardised information sheets before contract signature.[337] Against this background, ongoing asymmetries between the borrower and creditor persist.

Insufficiently comparable information as well as information which is complex and overly technical can inhibit consumer's ability to understand and to use the information provided, limiting consumer confidence and dissuading mobility. Although true at the domestic level, this is even truer for those consumers who do shop around cross-border. Creditors also face additional costs when seeking to operate cross-border.

2.3.2. Inconsistency between provision of information by lenders and provision of information by credit intermediaries

Another regulatory failure is the fact that the Code applies only to mortgage lenders and places no obligations on credit intermediaries, who frequently provide information to the consumer. Although in some Member States, such as Spain, the Association of Professional

330 See footnote 289.
331 COM(2007) 807.
332 For further information see Section 2.1 above on pre-contractual information.
333 *European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans: Second Progress Report on Implementation in the European Union*, European Banking Industry Committee, 13.12.2005, http://www.eubic.org/Position%20papers/Final%20Progress%20Report%20Clean%20-%20December%202005.pdf.
334 See footnote 282.
335 See footnote 282.
336 See footnote 136.
337 See footnote 136.

Investment and Finance Advisers[338] has committed to encouraging the use of the Code by credit intermediaries, and in some Member States, such as Austria, Belgium, Germany, Denmark, Italy and the Netherlands, credit intermediaries are required to provide the ESIS, such commitments elsewhere in Europe are generally lacking.[339]

Given the fact that just over 40 % of mortgage credit in the EU27 was provided via credit intermediaries, the inconsistency between information obligations for creditors and credit intermediaries means that in theory, even if all mortgage lenders committed to providing the ESIS, in 40 % of the instances, no ESIS would be provided. In reality this figure is likely to be lower, given the fact that some lenders will obtain commitments from credit intermediaries that they work with to use the ESIS as well as the commitment in some Member States by credit intermediaries to use the ESIS. This however does not detract from the fact that there is an unlevel playing field between creditors and credit intermediaries regarding the provision of pre-contractual information.

The consequence of this inequality is that some consumers will not receive the appropriate level of information to enable them to compare and understand the offers presented. For instance, in Poland, there is anecdotal evidence that credit intermediaries are failing to provide accurate information about the credit product and contract terms and in Slovakia the consumer is not always aware that the credit intermediary may be tied and thus only consider a limited number of products.[340] This limits consumer confidence and dissuades mobility. There is also a risk therefore that the consumer purchases an inappropriate product for their needs. Although true at the domestic level, this is even truer for those consumers who do shop around cross-border.

2.3.3. Timely receipt of pre-contractual information

Another instance of regulatory failure is the fact that the Code does not specify when pre-contractual information has to be given to the consumers. In a recent survey, only 7 % of consumers were given a standardised information sheet in one of the early meetings.[341] The 2003 review highlighted how differences amongst Member States in the moment at which the European Standardised Information Sheet is handed to the consumer could lead to different results when monitoring implementation.[342] In some Member States, such as Belgium, Denmark, France, Ireland, the Netherlands and Austria, the European Standardised Information Sheet is generally handed over together with a binding offer while in other Member States, such as Cyprus, Finland, Luxembourg and Sweden, the European Standardised Information Sheet is provided in advance of a binding offer.[343] In one Member State, Italy, the ESIS is only provided to customers upon request.[344] This unlevel playing field creates regulatory distortions for consumers and creditors alike.

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338 See footnote 288.

339 See footnote 282.

340 See footnote 6.

341 See footnote 136.

342 *Monitoring the uptake and the effectiveness of the Voluntary Code of Conduct on Pre-contractual Information for Home Loans*, institute for financial services e.V., June 2003, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/home-loans-final-report_en.pdf.

343 See footnote 136.

344 See footnote 136.

In order for consumers to be in a position to compare offers, the information has to be provided at a moment when the consumer is still able to shop around. If the information is provided at an advanced stage in the process of selecting a mortgage, such as at the moment the mortgage contract is being signed, the information can no longer play a role in facilitating the consumers' choice of mortgage product or informing them of the product characteristics. In such circumstances, there is insufficient time for the consumer to shop around domestically, let alone cross-border. This may lead to consumer detriment: the consumer end up purchasing the wrong product for their needs or at a higher price. In a recent review in the Netherlands into irresponsible lending practices it was found that consumers were general not provided with information in advance and there was hardly any time for the consumer to reflect.[345]

Furthermore, divergences in the timing for the receipt of information can lead to the consumer receiving information from one lender and not from another. The consumer is more likely to select the product that information is available on. This may place lenders in one Member State at a disadvantage when competing for business and create a distorted internal market.

2.3.4. Lack of comparability

Against the background of the abovementioned regulatory failures, research to date shows that significant market failures still remain.

Comparability is a key tool to better address consumer needs and is indispensable for the decision-making process of consumers. The need for comparability is even more pronounced for mortgage credit than for other products because of information asymmetries due to the complexity of mortgage products and the lack of familiarity of the different product features from the consumer's point of view. High quality comparable information can help promote consumer confidence and mobility by increasing the transparency of mortgage credit offers and reducing the time and effort to search for alternative providers thereby increasing the potential for customer mobility. For instance, standardised comparable offers were cited by consumers as the second most important factor which would persuade them to consider switching a mortgage credit provider (30.9 % of respondents).[346]

Despite the existence of the Code, which was designed to provide all European mortgage borrowers with standardised pre-contractual information, a 2008 survey found that almost 38 % of EU citizens still find it very or fairly difficult comparing offers from different mortgage credit providers.[347] This figure masks however large differences at the national level (see graph below).

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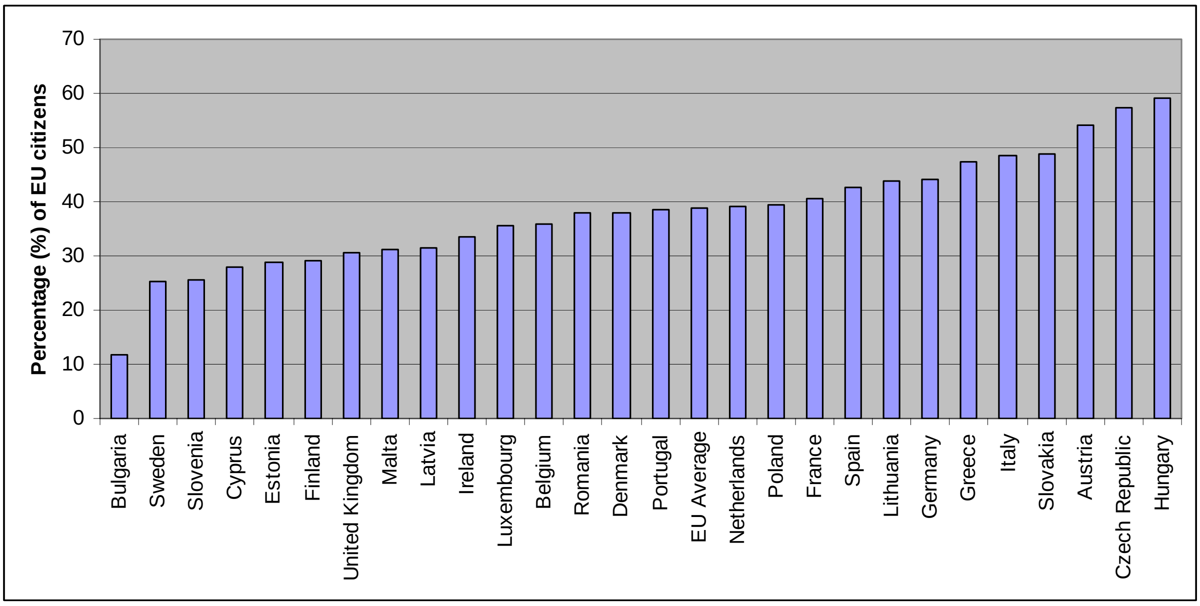
345 See footnote 244.

346 *Consumers' views on switching service providers*, *Annex tables*, Flash Eurobarometer 243, January 2009.

347 See footnote 346.

Graph 1: Percentage of people who find comparing information about different mortgages difficult



Source: *Consumers' views on switching service providers*, Flash Eurobarometer 243, January 2009.

Although progress has been made since the adoption of the Code of Conduct on home loans in 2001, the comparability of information on mortgage products is hindered in three ways: incomplete adherence to the Code of Conduct; a lack of comparability of the information contained therein, in particular the APRC; and adaptations of the ESIS to national market conditions.

First, incomplete compliance on the part of mortgage lenders to the Code means that consumers purchasing a mortgage credit product do not necessarily always receive the ESIS. Second, a comparison of offers from different Member States is currently difficult due to the different regimes for the cost base and methodology for the APRC. For instance, the APRC would be – all other parameters being equal – higher in Member States where certain insurance premiums have to be included in the cost base, than in those where it is not mandatory to include the cost of insurance. In order to exercise a rational decision for the best and most cost-effective product, a consumer would therefore have to compare the different regimes in terms of which cost elements enter the calculation base. Third, the existence of different national requirements for pre-contractual information and the calculation of the Annual Percentage Rate of Charge also mean that mortgage lenders, seeking to do business in more than one Member State face additional costs. The costs of developing additional IT systems and producing different information materials in accordance with differing Member State requirements can limit economies of scale and scope, thus deterring mortgage lenders from engaging in cross-border activity.

The inability to make accurate and meaningful comparisons between offers from local and foreign mortgage lenders would deter consumers from shopping around cross-border because real comparisons between the price of domestic and foreign mortgage products are not possible, therefore providing no incentive for consumers to shop cross-border for the best and most cost-effective product. This situation also creates an unequal playing field for mortgage lenders as some have taken the time and put in financial resources in order to comply with the Code while others have not.

Consumer testing undertaken by the Commission in 2007 confirmed that consumers expressed a strong interest in receiving standardised information.[348] This view has been reinforced with research undertaken in 2008: about 70 % of the consumers said that they would compare more offers if they received more useful information in a short and concise form designed to be easy to understand and to compare mortgage offers with one another.[349] 31 % of consumers in another survey also stated that standard comparable offers that would facilitate comparison would facilitate the switching process.[350]

2.3.5. Incomplete, complex and unclear information

Evidence collected by the European Commission during its consultation process appears to indicate the presence of market failures due to information asymmetries; more particularly, that the information currently provided to European consumers is insufficient in two ways: consumers do not necessarily have all the information that they require in order to make a decision and even if consumers do have the relevant information, they do not necessarily understand it.

According to a Eurobarometer survey from 2005, 59 % of EU citizens surveyed felt that it was difficult to understand the information given by financial institutions about the way their mortgages work and the risks involved, ranging from 30 % of consumers in Latvia and 33 % in Malta to 67 % in Germany and France and 76 % in Hungary.[351] Furthermore, research in the United Kingdom showed that UK consumers felt that the language used in the European Standardised Information Sheet was difficult to understand and overly technical for the average consumer.[352] Extensive consultations and research by the Commission has also indicated that the European Standardised Information Sheet might not contain all the necessary information a consumer might need.[353] Research also indicates that vulnerable consumers, i.e. consumers on low income levels or with low financial literacy, face particular problems in understanding the information provided; in consumer testing, more consumers from vulnerable households found the information provided not at all useful and more difficult to compare the costs of home loan products using the information provided to them.[354]

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348 For more information see http://ec.europa.eu/consumers/rights/docs/PCI_final_report_22Feb2008_en.pdf.

349 See footnote 136.

350 See footnote 346.

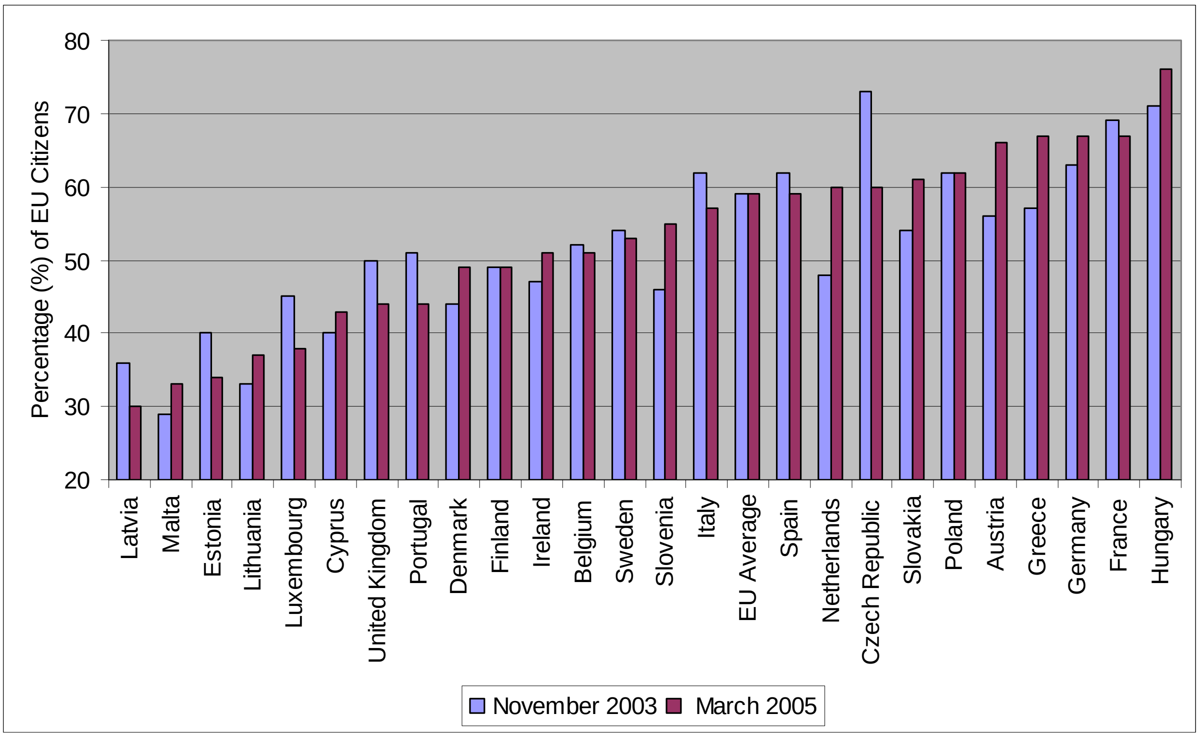
351 See footnote 81.

352 *The Draft Mortgage Sourcebook, including Policy Statement on CP 70*, Consultation Paper 98, UK Financial Services Authority, June 2001, http://www.fsa.gov.uk/pubs/cp/cp98.pdf.

353 See
White Paper on the Integration of EU Mortgage Credit Markets, COM(2007) 807 and the accompanying impact assessment, 18.12.2007, http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm;
Final Report of the Mortgage Industry and Consumer Dialogue, 20.12.2006, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/miceg/final_report-en.pdf and *Feedback on the Consultation on the Green Paper on Mortgage Credit*, 23.5.2006, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/feedback_gp-en.pdf.
Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, September 2009, http://ec.europa.eu/internal_market/finservices-retail/docs/credit/esis_report_en.pdf.
The Draft Mortgage Sourcebook, including Policy Statement on CP 70, Consultation Paper 98, UK Financial Services Authority, June 2001, http://www.fsa.gov.uk/pubs/cp/cp98.pdf.

354 See footnote 136.

Graph 2: Percentage of people who find it difficult to understand the information given by financial institutions about the way their mortgages work and the risks involved



Source: *Public Opinion in Europe: Financial Services*, Special Eurobarometer 203, August 2005

Consumer confusion and misunderstanding may be further compounded by the use of or misunderstanding of certain technical terms. According to recent research, only 41 % of consumers correctly identified the APRC as the best way to compare prices[355]. Focus Groups organised on behalf of the Commission also showed that a significant majority of participants in Czech Republic, Denmark, France, Hungary, the Netherlands, Poland, Spain and the United Kingdom did not know what the APRC stood for (only participants in Germany and Italy were aware of the fact that the APRC could be used to compare different mortgage offers).[356] Furthermore, many consumers base their decision on the price of the mortgage and some of those would use the APRC which is often seen by consumers as representing the actual price of the mortgage. However, the fact that different cost bases exist for the APRC mean that the price represented differs. This is confusing for consumers, many of whom would expect the APRC to represent the costs to be incurred. For example, consumers seeking cross-border offers may be attracted by a lower APRC. In reality, it may not be lower but just appear to be so because only a limited range of cost elements are included, leading to consumer detriment.

Consumer testing undertaken by the Commission in 2007 on pre-contractual information in the area of mortgage credit and on the ESIS confirmed that the information items currently included in the ESIS could be improved.[357] Consumers requested for instance a simplification/clarification of form and language, the addition of a glossary explaining

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355 See footnote 136. Another survey in the United Kingdom found that nearly four out of five people did not know that the APRC referred to the interest rate and other costs of the loan, *Financial Capability: A behavioural economics perspective*, FSA, 2008 from the London Economic study.

356 See footnote 136.

357 See footnote 348.

technical terms and precisions with regard to the nominal interest rate and the APRC[358]. These findings have been confirmed by consumer testing undertaken by the Commission in 2009.[359] While interviewed consumers unanimously agreed on the usefulness and necessity of such an information document, they frequently showed a lack of knowledge about the possible content of information items and often interpretations were erroneous when testing the current ESIS information titles. This was true in particular regarding the product description, the difference between nominal interest rate and APRC, additional costs and loan conditions. When further testing alternatives for presenting the content for different ESIS items, it became even clearer that understanding of key information items, such as the APRC, is generally low. In general, consumers showed a preference for the more detailed options and provided suggestions to improve the clarity of certain information titles or terms. Interviewees are also favourable to the idea of including risk warnings in the ESIS.

As mentioned above, credit intermediaries distribute approximately 40 % of mortgage credit in the EU. One of the key actors in the provision of information on credit offers to the borrower is therefore the credit intermediary. Credit intermediaries are however frequently remunerated based on commission from lenders for certain specific products.[360] Credit intermediaries may thus have a misaligned incentive[361] to recommend products based on their level of remuneration rather than the best product for the consumers' needs. Information asymmetries exist therefore not only between the creditor/intermediary and the borrower on the product being offered, but also about the incentives that may or may not exist to offer that particular product. Such asymmetries also exist for bank employees depending on their remuneration structure. There is anecdotal evidence that credit intermediaries have exploited rather than alleviated asymmetric information.[362] For example, consumer complaints in Slovakia seem to indicate that the consumer is not always aware that the intermediary may be tied to a specific lender and will thus consider only a limited number of products.[363] In addition, the responses to the public consultation on Responsible Lending and Borrowing provide insight in the practices conducted by credit intermediaries[364].

Insufficient information as well as information that is complex and overly technical can inhibit consumer's ability to understand and to use the information provided to select the most appropriate product for their needs, limiting consumer confidence and dissuading mobility. Although true at the domestic level, this is even truer for those consumers who do shop around cross-border. For example, the existence of Annual Percentage Rates of Charge which are based on different cost bases can be, at best, confusing or, at worst, misleading thus damaging consumer confidence in the single market. Abuse of information asymmetries can also lead to diminished consumer confidence and trust in the institutions concerned. For example, in the United Kingdom, research found that 35 % of consumers do not believe that

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358 See footnote 348.

359 *Consumer Testing of Possible New Format and Content for the ESIS on Home Loans*, September 2009, http://ec.europa.eu/internal_market/finservices-retail/docs/credit/esis_report_en.pdf.

360 See footnote 6.

361 Incentives of a remuneration scheme imposed on the credit intermediary which create a situation in which the credit intermediary is significantly engaged in a certain task, and at the same time the incentives of the remunerated scheme speak against the performance of that task.

362 See footnote 6.

363 See footnote 6.

364 *Summary of Reponses to the Public Consultation on Responsible Lending and Borrowing*, European Commission, November 2009. In this summary it was stated that intermediaries themselves referred to the recent practice of a different (less attractive) interest rate being applied to loans obtained through an intermediary than if obtained directly from the lender.

banks treat them fairly and 32 % felt that they do not trust their banks to sell them products that suit their needs.[365] Incomplete, complex and unclear information can also lead to consumers selecting an inappropriate product for their needs, potentially with consequences such as default or even foreclosure.

2.3.6. Summary of problems and consequences

Table 8: Problems and consequences

Problems	Consequences
Information: Lack of comparability Incomplete, complex and unclear information Lack of credible monitoring and enforcement mechanisms Inconsistency between provision of information by lenders and provision of information by credit intermediaries Timely receipt of pre-contractual information	**Risk of consumer detriment and reduced consumer mobility** – difficult to compare and understand offers => consumers purchase a product which is inappropriate for them or unnecessary => risk of inability to keep up with payments => risk of overindebtedness and foreclosure on home => reduced consumer confidence => if practices are widespread, risks for financial and economic stability **Missed opportunities for creditors and credit intermediaries** – unlevel playing field between creditors and credit intermediaries – dual or multiple burdens caused by different national rules on information => duplication of resources => unexploited economies of scale => higher costs for creditors => missed opportunities for cross-border business => restricted competition in the single market

2.4. Stakeholder views

Stakeholder views have been collected over time from a wide variety of sources, including the consultation on the Forum Group on mortgage credit[366], the Green Paper on mortgage credit[367], the mortgage industry and consumer dialogue,[368] and various Eurobarometer surveys[369].

2.4.1. Consumers

In general, consumers largely support a standard information sheet for comparing offers of financial services. 79 % of European citizens think that such a sheet with the same layout would be useful.[370]

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365 *Making Lending Responsible*, Which?, August 2007.

366 *The Integration of EU Mortgage Credit Markets*, Report by the Forum Group on Mortgage Credit, December 2004.

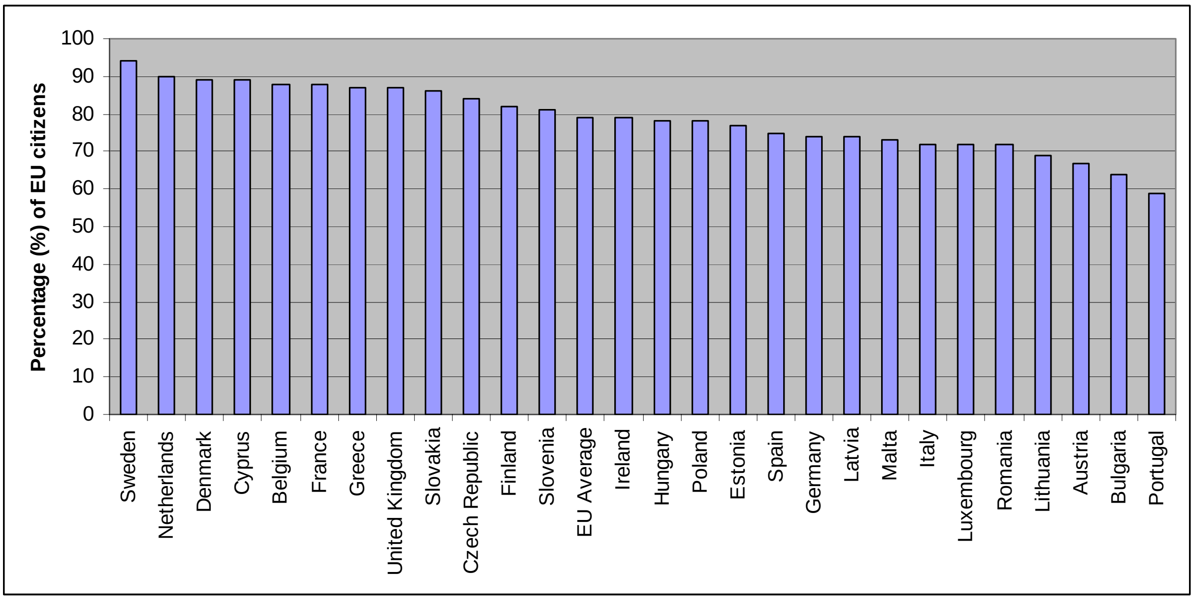
367 *Feedback on the Consultation on the Green Paper on Mortgage Credit*, 23.5.2006, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/feedback_gp-en.pdf.

368 *Final Report of the Mortgage Industry and Consumer Dialogue*, 20.12.2006, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/miceg/final_report-en.pdf.

369 *Consumer protection in the internal market*, Special Eurobarometer 298, October 2008.

370 See footnote 369.

Graph 3: Percentage of citizens who find it useful if all financial service providers used a standard information sheet provided in the same layout in order to allow compare prices and offers

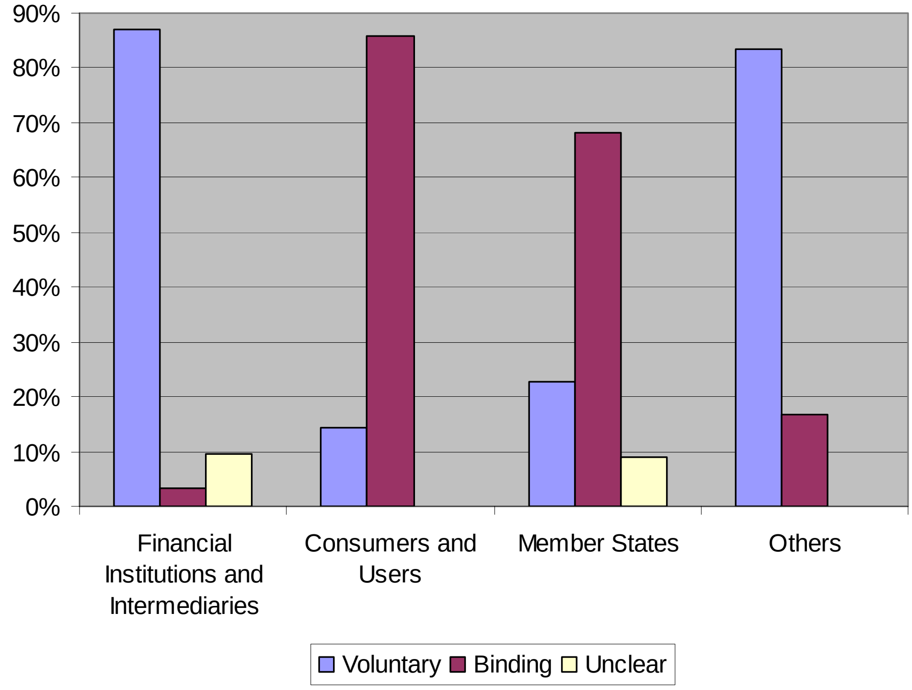


Source: *Consumer protection in the internal market*, Special Eurobarometer 298, October 2008, p. 123

When it comes to the legal nature of the Code, the majority of consumers support the introduction of binding legislation in the area of pre-contractual information, i.e. replacing the existing voluntary Code of Conduct by legislation, due to insufficient implementation of the Code by mortgage lenders and the absence of credible enforcement mechanisms.[371]

[371] See footnotes 367 and 368.

Graph 4: Should the Code of Conduct be replaced by binding legislation or remain voluntary?



Source: *Feedback on the Consultation on the Green Paper on Mortgage Credit*, 23.5.2006, p. 10

Consumers also emphasise the need to improve the content of the European Standardised Information Sheet.[372] During the Forum Group on Mortgage Credit, European consumer organisations underlined the importance of broadening the scope of its information.[373] These findings were also supported in the contributions to the Green Paper consultation, which presented several proposals for additional information, for example on foreign currency loans, to be included in the information to consumers. The Mortgage Industry and Consumer Dialogue considered possible modifications of the Code of Conduct. Although a final agreement on a revised European Standardised Information Sheet was not reached, progress was made on certain items. A consensus began to emerge on possible changes to some existing ESIS items like 'Description of product' and 'Amount and currency'. In general terms, the idea of 'risk warnings' was also received rather positively.

With regard to the moment at which the European Standardised Information Sheet should be handed to consumers, consumers are of the opinion that the European Standardised Information Sheet should be given without undue delay after the consumer has given the necessary personal information and, in any event, before the conclusion of the contract, enabling the consumer to use the information contained in the European Standardised Information Sheet in order to compare the offers available on the market, to assess the implications of the product considered and to take a decision.[374] The majority of consumers were of the view that the notion of 'sufficient time' should mean at least 14 calendar days,

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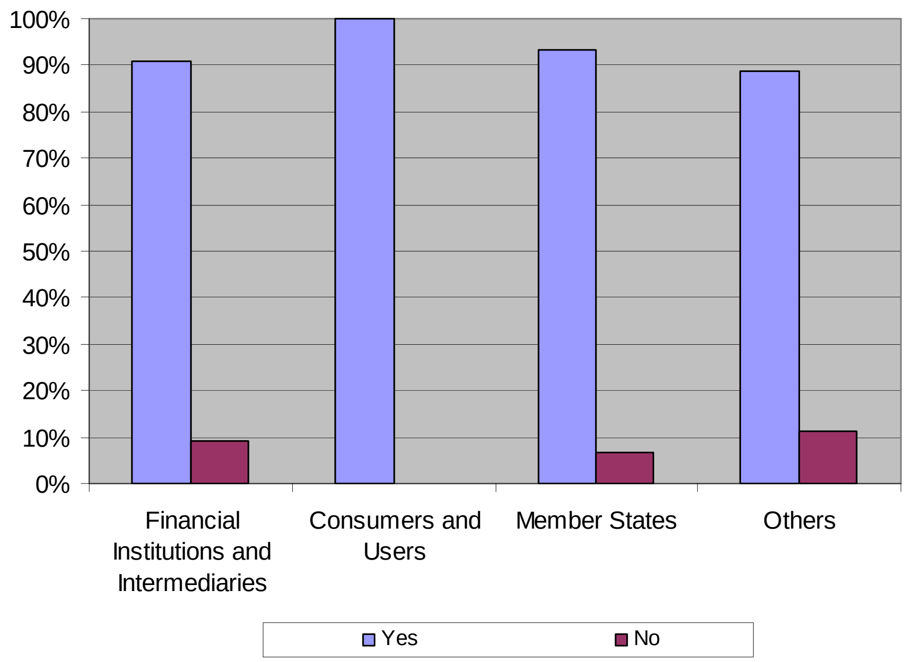
[372] See footnotes 367 and 368.
[373] See footnote 366.
[374] See footnote 368.

under which consumers would have the option to sign at any given time without having to wait for the 14 days' period to elapse.[375]

Consumers are in favour of harmonising the Annual Percentage Rate of Charge both in terms of methodology and cost basis at the European level.[376] They support a wide cost basis, i.e. including all costs that the consumer has to pay in connection with the credit, including, for instance, notary costs and taxes.[377] Only those costs which are truly optional for the consumer could be excluded.

Graph 5: Should the APR be harmonised?



Source: *Feedback on the Consultation on the Green Paper on Mortgage Credit*, 23.5.2006, p. 22

2.4.2. Mortgage lenders

The majority of mortgage lenders are opposed to the introduction of any binding legislation and considers that the European Standardised Information Sheet in its current form is well designed and balanced.[378] With regard to the moment at which the ESIS is provided to consumers, mortgage lenders agree that the European Standardised Information Sheet should be given without undue delay after the consumer has given the necessary personal information and, in any event, before the conclusion of the contract, enabling the consumer to use the information contained in the European Standardised Information Sheet in order to compare the offers available on the market, to assess the implications of the product considered and to take a decision. However, industry is not in favour of an introduction of a 14-day period as suggested by consumers.[379]

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375 See footnote 368.
376 See footnotes 367 and 368.
377 See footnote 368.
378 See footnote 368.
379 See footnote 368.

The majority of mortgage lenders are – like consumers – also in favour of harmonising the Annual Percentage Rate of Charge both in terms of methodology and cost basis at the European level.[380] However, mortgage lenders support a narrow cost basis, arguing that only those costs levied by the lender for the loan for his own benefit should be taken into account when calculating the Annual Percentage Rate of Charge.[381]

2.4.3. Member States

Member States are divided in their views as to whether the Code should be replaced by binding legislation with a majority of supporting the introduction of binding legislation (see Graph 4).[382]

With regard to a harmonisation of the Annual Percentage Rate of Charge on the European level, the vast majority of Member States support the need for a harmonised Annual Percentage Rate of Charge both in terms of the methodology used to calculate it and the costs base (see Graph 5).[383] Member States are more divided in their views as to which cost elements should be taken into account.[384] Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Norway, Romania, Slovenia, Spain[385] and Sweden are all applying the APRC from the CCD. Other Member States, such as Bulgaria, Belgium, Czech Republic, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Slovakia and the United Kingdom have however decided against applying this article to mortgage credit.

2.5. Objectives

2.5.1. General objectives

– To create an efficient and competitive Single Market for consumers, creditors and credit intermediaries with a high level of consumer protection by fostering:

  – consumer confidence;

  – customer mobility;

  – cross-border activity of creditors and credit intermediaries;

  – a level playing field.

– Promote financial stability throughout the EU by ensuring that mortgage credit markets operate in a responsible manner.

2.5.2. Specific objectives

– Provide consumers with the means to make informed decisions in sufficient time to enable them to shop around.

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380 See footnotes 367 and 368.
381 See footnote 368.
382 See footnote 367.
383 See footnote 367.
384 See footnote 367.
385 See footnote 224.

2.5.3. Operational objectives

– Ensure that the information provided is comparable, both nationally and across the EU.

– Ensure that the information provided is complete, clear and in manner that is easy for consumers to understand.

– Ensure that the framework on information is properly monitored and enforced.

– Ensure that all creditors and credit intermediaries provide adequate information.

– Ensure that the information is provided in sufficient time for the consumer to shop around.

– Ensure that information is provided to the consumer automatically.

– Ensure that originators and distributors operating cross-border do not need to comply with heterogeneous sets of information requirements.

2.6. Description of policy options

2.6.1. Option 1: Do nothing

The ESIS would remain unchanged in form and content and only available from those lenders that have subscribed to the Code of Conduct. Enforcement and monitoring of the Code would remain weak. Neither the cost base nor the methodology for calculating the Annual Percentage Rate of Charge would be harmonised, thus the definition of the APRC left to the Member States. The issue of timing would not be tackled, and many consumers would continue to receive the ESIS too late for them to be able to shop around. No additional pre-contractual information requirements would be introduced.

2.6.2. Option 2: Ensure that consumers receive the ESIS

All actors interacting directly with consumers – be they creditor or credit intermediary – will need to provide the ESIS. This could be done in different ways, e.g. reinforcing existing self-regulatory monitoring and enforcement mechanisms or by introducing new obligations.

2.6.3. Option 3: Ensure that the ESIS is provided in time to enable consumers to shop around

Option 3 will mean that not only consumers will receive the ESIS (i.e. Option 2) but also that it will be provided early enough in the process for consumers to be able to shop around and compare offers.

2.6.3.1. Option 3.1: Principles-based requirement

A principles-based requirement for when to provide the European Standardised Information Sheet could be introduced. Such a requirement could be based on Article 5.1 of the CCD which requires information to be provided "in good time before the consumer is bound by any credit agreement or offer". Alternatively, a requirement could be based on the wording discussed in the Mortgage Industry and Consumer Dialogue, such as the information "should be given without undue delay after the consumer has given the necessary personal information and, in any event, before the conclusion of the contract, enabling the consumer to use the information contained in the ESIS in order to compare the offers available on the market, to assess the implications of the product considered and to take a decision"[386] or the information should be given in "sufficient time to compare offers"[387].

Under this policy option, Member States would be able to define 'in good time' or 'sufficient time' or 'without undue delay' according to national practices.

2.6.3.2. Option 3.2: Specify a deadline for the provision of information

This policy option could introduce a requirement defining exactly when in the sales process, the information must be provided, for example, at least 10 days or 14 calendar days[388], before contract signature. This could lead to more opportunities to consider and use the information to shop around, compare products and providers and, in consequence, make an informed choice on the right product. This option could either be considered as it stands or with an explicit waiver for consumers so as to enable them to proceed more quickly should they so wish.

2.6.4. Option 4: Improve the format and content of the ESIS

A revamped ESIS would be implemented. The ESIS would be improved in order to meet consumers' information needs and to increase their understanding of loan characteristics and risks. A revamped ESIS will also aim at enabling potential borrowers to better compare offers from different lenders and make an informed choice of product. To take account of market developments, implementing measures may be considered in the event a legislative instrument is chosen.

2.6.5. Option 5: Standardise the Annual Percentage Rate of Charge

2.6.5.1. Option 5.1: Standardise on the basis of a narrow definition

The APRC could be standardised along the lines of the narrow APRC concept covering only those costs levied by the lenders for the loan for their own benefit.[389] In detail, these costs include borrowing costs, discount origination, premium origination, loan closing costs, lender property appraisal fees[390], lender credit assessment fees, account maintenance fees and discounts given by the lender. In the event of a legislative initiative, regulatory standards could be developed to modify the method of calculation of the APRC.

2.6.5.2. Option 5.2: Standardise on the basis of Article 19 of the CCD

An alternative policy option would be to standardise the APRC along the lines of the provisions in the CCD. The CCD definition of the APRC is based upon the concept of 'total cost of the credit to the consumer' that means "all the costs, including interest, commissions, taxes and any other kind of fees which the consumer is required to pay in connection with the credit agreement and which are known to the creditor, except for notarial costs; costs in

386 See footnote 368.
387 See footnote 368.
388 See footnote 368.
389 Definition taken from the *Final Report of the Mortgage Industry and Consumer Dialogue*, see footnote 368.
390 This refers only to appraisal fees that accrue to the lender.

respect of ancillary services relating to the credit agreement, in particular insurance premiums, are also included if, in addition, the conclusion of a service contract is compulsory in order to obtain the credit or to obtain it on the terms and conditions marketed". Vis-à-vis Option 5.1, this means that costs not levied by the lenders for their own benefit, such as taxes, will be included.

In the event of a legislative initiative, regulatory standards could be developed to modify the method of calculation of the APRC.

2.6.5.3. Option 5.3: Standardise on the basis of a broad definition

A broad definition of the APRC would cover all costs that the consumer has to pay in connection with the mortgage. For example, notary fees on title transfer or legal advisory fees as well as third-party appraisal costs[391] could be included in the APRC. Going beyond the requirements of the CCD would reflect the higher level of risk and commitment that mortgage credit entails. In the event of a legislative initiative, regulatory standards could be developed to modify the method of calculation of the APRC.

2.6.6. Option 6: Additional pre-contractual information

The European Standardised Information Sheet contains information exclusively on the product. As described above, one of the key actors in the provision of information to the borrower is the credit intermediary who may face misaligned incentives[392]. To limit the impact of information asymmetries in this respect, further information on the intermediary may be useful or even necessary. Consequently, additional pre-contractual information requirements could be introduced, such as a requirement for disclosure on the independence (tied, multi-tied, independent), costs associated with the intermediations and/or advice service, product availability/market coverage (whole of the market, parts of the market, single firm) and remuneration (commissions, fees) of the mortgage sales person. Further pre-contractual information could also raise awareness of underlying incentives structures that may not in line with those of the consumer. Some of the additional information may also be provided by bank staff, since the aforementioned misaligned incentives could also exist for certain bank employees. To take account of developments and to ensure uniform application, implementing measures may be considered in the event a legislative instrument is chosen.

2.7. Description of options for policy instruments

Each of the above options could be given effect through a variety of different policy instruments. These include a Commission Recommendation or Communication, industry self-regulation (Code of Conduct), and Community legislation in the form of a Regulation or Directive. Table 9 below explores the feasibility of giving effect to each of our policy options through each of the available policy instruments.

391 This refers to appraisal fees that accrue to a third party even if the third party is contracted by the lender in order to undertake the appraisal on the lender's behalf.

392 Incentives of a remuneration scheme imposed on the credit intermediary which create a situation in which the credit intermediary is significantly engaged in a certain task, and at the same time the incentives of the remunerated scheme speak against the performance of that task.

Table 9: Pre-contractual information – Policy options versus instruments

Policy options: content vs instrument	Self-regulation	Recommendation	Communication	Directive	Regulation
1: Do nothing					
2: Ensure that consumers receive the ESIS	X	X		X	X
3: Ensure that the ESIS is provided in time to enable consumers to shop around	X	X		X	X
4: Improve the format and content of the ESIS	X	X		X	X
5: Standardise the APRC		X		X	X
6: Additional pre-contractual information	X	X		X	X

Doing nothing does not require the use of any policy instrument. Beyond that the possibility of doing nothing, as can be seen from Table 9, it is feasible to give effect to any of the policy options through any of the five policy instruments except via a Communication. This is because of the very nature of a Communication: it is a tool used simply to communicate information to the Member States, in contrast to the rest of the instruments that, once adopted, operate to effect a particular change in the way things are done. The following sections will assess the impact of the policy options and will describe which policy instrument is the most appropriate to use, as well as the underlying reasons for the choice.

2.8. Assessment of policy options

2.8.1. Option 1: Do nothing

2.8.1.1. Effectiveness of policy option

Doing nothing would mean that all the problems identified remain. The ESIS would remain unchanged in form, content and timing and only be available from those lenders who have subscribed to the Code of Conduct. Given the lack of progress both in the Mortgage Industry and Consumer Dialogue and the lack of interaction between the Code signatories, few developments can be expected in this area. APRC would not be harmonised and the cost elements to be taken into account to calculate the APRC left to the Member States. The problems of price transparency and comparability, particularly cross-border, would remain. Consumers would continue to be at risk due to information asymmetries with the mortgage distributor, in particular due to the possible existence of misaligned incentive structures of the firm and/or person who is selling the mortgage.

Moreover, although adhesion has improved since 2001, there are still issues of adherence and compliance with the Code.[393] Not all lenders have signed up to the Code and there is still a lack of credible monitoring and enforcement mechanisms. Besides the Code, Member States have either specific statutory laws or Codes of Conduct in place, covering information

[393] See footnote 282.

obligations for mortgage credit.[394] Non-harmonised pre-contractual information requirements do affect creditors and credit intermediaries operating cross-border as they need to comply with more than one set of pre-contractual information which implies a duplication of resources, unexploited economies of scale and, in consequence, higher costs for creditors and credit intermediaries. This can severely impede the propensity of firms to do business in other Member States.

2.8.1.2. Impacts of policy option on stakeholders and efficiency

Consumers would continue to receive incomplete information at different times that is difficult to understand and not fully comparable across EU. Customer mobility would remain impaired and costly. Consumer confidence, particularly amongst vulnerable consumers with low levels of financial literacy or incomes, would remain weak and could even deteriorate if creditors currently providing the Code stopped doing so.

There would be no level playing field between creditors who have invested time and resources to implement the Code of Conduct and those who have not done so. The lack of a level playing field between creditors, who provide the ESIS, and credit intermediaries who generally do not, would also persist. Multiple sets of information requirements would continue to exist. Creditors would remain subject to a range of different information requirements across Europe reducing the scope for economies of scale and scope when engaging in cross-border activity.

Nonetheless, the possible extension by a number of Member States[395] of the CCD provisions on pre-contractual information to mortgage credit would lead to mixed effects. On the one hand, it would mean that pre-contractual information between those Member States fully applying the CCD provisions on pre-contractual information to mortgage credit would be fully comparable, thus facilitating transparency and shopping around, thus competition. However, these positive effects would be mitigated to some extent by the fact that the Standard European Consumer Credit Information would not necessarily take into account the specificities of mortgage credit (duration, risks, home as collateral, etc.) and thus promote consumers understanding of the products under consideration. On the other hand, given that the majority of EU Member States, including the largest mortgage markets, such as the United Kingdom and Germany, will not extend the CCD provisions to mortgage, or will do so only partially, the impact will be limited. One of the key reasons for not applying, or only partially applying, the CCD provisions to mortgage credit is to take into account the specificities of mortgage credit, thus facilitating, at least in theory, the provision of pre-contractual information which is tailored to consumers purchasing mortgage credit, such as the ESIS.

2.8.2. Option 2: Ensure that consumers receive the ESIS

2.8.2.1. Effectiveness of policy option

This option would address some of the problems identified, notably the comparability of different mortgage credit products across the EU. If the Code of Conduct was applied

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394 See footnote 136.

395 The following 13 countries are extending some or all the pre-contractual information provisions of the CCD to mortgage credit: Belgium (only SECCI Annex), Bulgaria, Denmark, Estonia, Italy (but not the SECCI Annex), Cyprus, Malta, Austria, Romania, Slovenia, Slovakia, Finland (but not the SECCI Annex) and Sweden.

consistently across Europe by creditors, then comparability would be substantially enhanced. This would encourage consumers to shop around for the best product and deal, thus promote customer mobility and competition. At the same time however, simply ensuring that consumers receive the ESIS would not improve either the quality of the information provided or the understanding of the consumers receiving it. Given financial literacy levels, providing consumers with additional information does not mean that this would help them to better choose among credit products. A survey carried out in France, Spain and Italy showed that a large proportion of people on low incomes paid no attention to the difference in costs and terms between financial institutions, and were not able to evaluate them.[396] Efforts to improve financial literacy could therefore enhance the effectiveness of this option.[397] However, parallel measures, e.g. ongoing efforts in Member States and Commission initiatives undertaken in the wake of its 2007 Communication aim to improve levels of financial literacy are out of the scope of this analysis and, therefore, interaction with the identified options will not be discussed.

Implementation of this option would most likely neither contribute to ensuring that the ESIS is provided in sufficient time for the consumer to shop around. Consequently, in terms of the effectiveness in consumers choosing a more suitable product, the impact will be negligible, as will the impact on creditors' levels of default and financial stability.

Cross-border activity would be encouraged due to the common use of the ESIS, however this benefit would be somewhat offset by the continued existence of national legal provisions on pre-contractual information which would still need to be met in the event of a non-legislative tool being chosen. Additional provisions would also have to be introduced or the scope widened to ensure that the ESIS was provided by both creditors and credit intermediaries. Greater enforcement of the ESIS on its own is therefore unlikely to contribute greatly to the promotion of a competitive and efficient single market for mortgage credit.

However, the real effectiveness of this option would be dependent on the effectiveness of the mechanism chosen to ensure that consumers actually receive the ESIS (e.g. improved implementation and enforcement of the Code of Conduct or new regulatory obligation). The choice of instrument would thus be critical. The question of the most appropriate policy instrument is analysed in more detail in Section 2.9 below.

2.8.2.2. Impacts of policy option on stakeholders and efficiency

Consumers would face some benefits through the increased comparability of information. This would encourage consumers to shop around between creditors and credit intermediaries for the best product and deal, thus promote customer mobility and competition. However, these benefits would be largely offset by the persistence of other problems. Notably, consumers would continue to receive incomplete information that is difficult to understand, particular for those consumers with low levels of financial literacy, and be provided at different times. Customer mobility would on the whole therefore remain impaired and costly, except for more educated and informed consumers who would be able to take advantage of

[396] *Access to Credit: the Difficulties of Households, New Frontiers in Banking Services: Emerging Needs and Tailored Products for Untapped Markets*, Nieri, Springer Verlag, Berlin, 2006.

[397] Research on the effectiveness of pre-purchase home ownership counselling among lower-income borrowers in the US has found that potential borrowers who receive this counselling before buying have on average a 13% lower delinquency rate. Source: Empirical Evidence of the effectiveness of pre-purchase homeownership counselling, Hirad, Zorn, May 2001.

the comparability of information. Overall, the impact on consumer confidence, particularly the confidence of less financially educated and more vulnerable consumers, is therefore likely to remain weak as is the impact on financial stability.

The level playing field between mortgage lenders would be enhanced (i.e. between those who have invested time and resources to implement the Code of Conduct and those who have not yet done so). Provided some additional measures were included to level the playing field between mortgage lenders, who provide the ESIS, and credit intermediaries who generally do not, then a more equal playing field would be created. Those creditors and credit intermediaries who do not currently provide the ESIS and who would do so after the policy option would occur one-off costs to develop new systems and processes, as well as train staff. All creditors would also face recurrent costs in providing more European Standardised Information Sheets as well as more monitoring compliance with the Code or binding legislation (depending on the policy instrument chosen). Creditors are also likely to bear the cost of additional monitoring and enforcement by an external body: either an independent body or the regulator depending on the policy instrument chosen.

Multiple sets of information requirements could continue to exist, particular in the case a self-regulatory instrument is chosen. Should Member States continue to maintain their existing pre-contractual information requirements on top of the ESIS (as would appear likely given that many of the obligations are relatively newly introduced following decisions to extend the CCD to pre-contractual information on mortgages), creditors would remain subject to a range of different legal information requirements across Europe reducing the scope for economies of scale and scope when engaging in cross-border activity. Under such circumstances, the additional costs faced by creditors seeking to engage in cross-border activity could even increase due to the need to provide both the ESIS and the standard information sheet required under national law. However, in contrast, in the event a legislative instrument is chosen, cross-border activity by creditors and credit intermediaries could be stimulated as economies of scale and scope would become available as they would only need to comply with one set of information disclosures.

Member States would face costs of supervision and enforcement in the event of a regulatory instrument being chosen. Most Member States would benefit from better monitoring and enforcement through more competition between creditors. However, some exceptions exist namely, Germany, where already a large number of creditors provide the ESIS, and the United Kingdom, where consumers would neither gain nor lose as a result of replacing the current information disclosures.[398]

2.8.2.3. Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 150–300 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 2.5–5 basis points due to the consumer receiving an ESIS which will enable them to more readily compare offers and thus select a more appropriate product for their needs.

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[398] See footnote 136.

– This is equivalent to mortgages of EUR 150–300 million[399].

– This figure contains a discount to reflect that in 14 Member States (Austria, Belgium, Germany, Hungary, Malta, the Netherlands, Portugal, Sweden, Slovakia, Luxembourg, Finland, Greece, Estonia and Denmark) more than 90 % of the market provides the ESIS and/or creditors are obliged to provide the ESIS either through self-regulation or through regulatory rules.[400] It is assumed that in those instances, credit intermediaries also provide ESIS either as a result of a direct obligation or through a contractual obligation through their relationship with the creditor.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[401].

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 90 million in one-off costs and EUR 72 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 40 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 50 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[402] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[403]

– Annual recurring costs are estimated at EUR 51 million for creditors and EUR 21 million for credit intermediaries. Annual recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the costs of the action in terms of additional time spent with the client to obtain all the relevant information. These figures are based on the assumptions that compliance takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees approximately 0.5 hours to collect all the relevant information from the consumer to prepare the ESIS.

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399 See footnote 277.
400 See footnote 282.
401 See footnote 268.
402 This 20/80 % assumption is based on the fact that credit institutions have much more staff than credit intermediaries, the latter often being an entity of 3–4 people.
403 No concrete data is available. However, the estimate of 30 man days is based on informal discussions with stakeholders. See footnote 136.

– The costs for creditors and credit intermediaries contains a discount to reflect that in 14 Member States (Austria, Belgium, Germany, Hungary, Malta, the Netherlands, Portugal, Sweden, Slovakia, Luxembourg, Finland, Greece, Estonia and Denmark) more than 90% of the market provides the ESIS and/or creditors are obliged to provide the ESIS either through self-regulation or through regulatory rules.[404] It is assumed that in those instances, credit intermediaries also provide ESIS either as a result of a direct obligation or through a contractual obligation through their relationship with the creditor.

Member States will face EUR 0.3 million in one-off costs and between EUR 0.33 million and EUR 0.99 million in annual recurring costs in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.3 million. This is based on the assumption in a recent study[405] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that 13 Member States would also have to modify their legal framework. In reality, this number may be slightly more since although the ESIS may be provided throughout certain markets, this could be the result of self-regulation rather than regulatory action.

– Annual recurring costs of monitoring and ensuring that the ESIS is provided would be between EUR 0.33 million and EUR 0.99 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed.

– The 13 Member States that are assumed to have to modify their frameworks would also face annual recurring costs in terms of supervising and enforcing the legal framework. An estimate of between EUR 0.33 million and EUR 0.99 million for annual recurring costs for Member States is made based on the assumption that this would take between 1 and 3 hours. Similarly, these figures may be slightly more since although the ESIS may be provided throughout certain markets, this could be the result of self-regulation rather than regulatory action.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

2.8.3. Option 3: Ensure that the ESIS is provided in time to enable consumers to shop around

Considering that this option entails that the ESIS is provided to consumers (i.e. Option 2) it can be expected that it is more effective and have greater impacts on stakeholders than Option 2. However, this will very much depend on how this policy option is implemented.

[404] See footnote 282.
[405] See footnote 136.

2.8.3.1. Option 3.1: Principles-based requirement

Effectiveness of policy option

A principles-based requirement has the potential to ensure that the consumers has sufficient time to shop around and compare offers, thus facilitate customer mobility and improve competition on a domestic as well as cross-border basis. Member States would be left to define what is meant by 'in good time' or 'sufficient time'. This could be done in a variety of ways, such as through the court system, via self-regulation, or through regulatory or legislative means. In terms of its effectiveness, this option would be dependent on exactly how it was implemented in various Member States. On the one hand, if no further guidance was given, then it would be left up to each individual provider/intermediary to decide upon their own definition of good time. Consequently, some creditors and credit intermediaries may simply decide that their current practice is already to provide the ESIS in good time and thus nothing would change. On the other hand, a patchwork could emerge either with or without regulatory guidance from the Member States, where one provider does one thing and another provider does another thing. This inconsistency means that consumers would find it difficult to compare offers.

This policy option would not contribute to enhancing the understandability or comparability of the information provided (see Section 2.8.2.1), nor would it be able to promote a level playing field between creditors themselves or between creditors and credit intermediaries. Consumer detriment would be reduced but would not be eliminated entirely. Consequently, while this policy option could stimulate competition in the market and thus promote market integration, the impact on financial stability is likely to be more limited.

Impacts of policy option on stakeholders and efficiency

Consumers would theoretically receive the information sufficiently in advance to allow the comparison of offers, facilitating mobility and competition. This should enable consumers to shop around for the best product and deal to meet their needs, thus reducing the number of inappropriate products being sold, to the benefit of both social and financial stability. However, given that a principles-based definition for the timing would not specify how far in advance the information is provided, different options could ensue: Member States could interpret the principles differently resulting in a regulatory patchwork; different creditors could also interpret the principles differently resulting in an ad hoc provision of information; etc. Under such circumstances, consumers are likely to be provided the information at different moments either domestically and/or cross-border. This would make comparisons and shopping around difficult, thus largely mitigating any positive impact.

Creditors and credit intermediaries would continue to provide the ESIS, albeit it possibly at an earlier stage in the process that they would do normally. The lack of any clear guidance on exactly when the ESIS should be provided could however lead to differences in the timing at either the domestic or cross-border level. This could in fact increase the unlevel playing field, particularly on a cross-border basis as in the event of differing regulatory interpretations between Member States, different rules would have to be complied with.

Member State provisions on the timing of pre-contractual information would generally remain unchanged. Where no such provisions may exist, some Member States may decide that clarification of principles-based terms may be required and thus take regulatory or legislative action to provide further guidance.

Quantification of costs and benefits

Consumers and society in general will on balance face no benefits in addition to those already identified for Option 2. This is due to the fact that with a principles-based guidance, any potential benefits are offset by the fact that uncertainty would exist about when the ESIS is provided and thus consumer confidence would suffer and consumer detriment would persist.

Unless Member States provide more detailed guidance on when the ESIS should be provided, creditors and credit intermediaries would also face no additional costs (as compared to Option 2) since they would be free to determine their own interpretations of 'in good time'. Equally, they would not be able to benefit. Furthermore, in the event that Member States provided differing interpretations of good time, creditors and credit intermediaries could also have a negative impact as they could face increased costs in terms of reduced economies and scale and scope for engaging in cross-border activity.

Member States would face costs only in the event a legislative instrument is chosen and/or they chose to provide regulatory guidance on the interpretation of the principles-based measure. The one-off costs for Member States could therefore range from EUR 23 529 if one Member State decided to adopt measures to EUR 0.64 million if all Member States took legislative action. Annual recurring costs can be expected to range between EUR 0.68 million and EUR 2 million in the event a legislative instrument is chosen. These include the costs already identified under Option 2. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption that all 27 Member States would have to modify their framework to take into account the principles-based rules on when the ESIS should be provided.

– Annual recurring costs of monitoring and ensuring that the revised ESIS is provided according to those rules would be between EUR 0.68 million and EUR 2 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed.

2.8.3.2. Option 3.2: Specify a deadline for the provision of information

Effectiveness of policy option

A specification, for example, to ensure that the ESIS is provided at a particular moment in time (e.g. 10 or 14 days before contract signature), has the potential to ensure that the consumers has sufficient time to shop around and compare offers, thus facilitate customer mobility and improve competition on a domestic as well as cross-border basis. The effectiveness of this option would be dependent on exactly when the deadline would be set. For instance, setting the deadline at 24 hours prior to contract signature would not necessarily enable consumers, particular vulnerable consumers with low levels of financial literacy, to adequately shop around and compare offers (creditors could wait until the last minute to provide the information and hope that being the most recent information, the consumers would opt for their product), it would also reduce the ability of consumers to negotiate with creditors as contract negotiations would already be at an advanced stage. In contrast, setting the deadline for the provision of the ESIS 10 or 14 days before contract signature would give the consumer a reasonable amount of time to shop around and compare as well as consider different mortgage products.

While this policy option would be more effective that the option of ensuring simply that consumers receive the ESIS (Option 2), it would neither contribute to enhancing the understandability or comparability of the information provided (see Section 2.8.2.1), nor would it be able to promote a level playing field between creditors themselves or between creditors and credit intermediaries. Consumer detriment would be reduced but would not therefore be eliminated entirely. Consequently, while this policy option could stimulate competition in the market and thus promote market integration, the impact on financial stability is likely to be more limited.

<u>Impacts of policy option on stakeholders and efficiency</u>

Depending on exactly when the deadline/moment would be set, consumers would receive the information sufficiently in advance to allow the comparison of offers, facilitating mobility and competition. This should enable consumers to shop around for the best product and deal to meet their needs, and provide consumers with sufficient time to carefully consider the best offer. However, given that there is no impact on the understandability of the information, there is no guarantee that consumers would necessarily select the most appropriate product for their needs. Consequently, any reduction in the number of inappropriate products being sold and thus the benefit of both social and financial stability is likely to be more limited. At the same time, those consumers who know exactly which product they wish to purchase as a result of earlier shopping around may be prevented from making a decision more quickly. Consequently, a consumer waiver of the set deadline may also be considered. While the existence of a waiver would enable consumers who are already well informed and know their choice of product to move to contract signature more quickly, there is always a risk that more vulnerable consumers, particular those with low levels of financial literacy, are pressurised into signing a waiver in order to force them into a particular deal.

Creditors and credit intermediaries would have to amend processes and train staff to ensure that the ESIS was provided within the set deadline. Internal compliance mechanisms would have to be established and/or developed to ensure that the deadline was being met. Creditors in some Member States where the ESIS is currently provided as a binding offer at a late stage in the negotiation period between the creditor and consumer would have to modify their processes so that the ESIS is provided as a non-binding information document (as it was designed to be) at an earlier stage. Such creditors would therefore face additional costs in adapting their processes. In the event that a waiver for consumers is introduced, then all creditors and credit intermediaries would have to amend their processes to incorporate such a waiver. In terms of cross-border activity, the establishment of a pan-European deadline would contribute to a level playing field across the EU. According to industry representatives, this set time period would introduce an element of standardisation, and limit competition.

Member State provisions on the timing of pre-contractual information may have to be modified depending on the exact deadline chosen. For example, should it be decided to require the information to be provided 14 calendar days before contract signature, France would have to alter its 10-day mandatory period of reflection. Similarly, Member States where the contract is provided alongside a legally binding offer may have to modify their system. For example, in Denmark, the ESIS is generally provided alongside an offer, which although it is valid for six months, the price of the mortgage would normally vary so that the market costs of the bonds covering the mortgage are accurately reflected in the cost of the mortgage.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 337–611 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 1.5–2.5 basis points, in addition to the reduction estimated for Option 2, since the consumer will not only receive the ESIS but s/he will also receive it in time to compare offers and thus select a more appropriate product for their needs.

– This is equivalent to mortgages of EUR 337–611 million[406].

– This figure is based on the assumption that all Member States would have to modify their framework to take into account specific rules on when the ESIS should be provided.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[407].

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 185 million in one-off costs and EUR 151 million in annual recurring costs. These include the costs already identified under Option 2. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 81 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 104 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[408] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[409]

– Annual recurring costs are estimated at EUR 107 million for creditors and EUR 44 million for credit intermediaries. Annual recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the additional costs of the action in terms of time spent with the client to obtain all the relevant information. These figures are based on the assumptions that compliance

[406] See footnote 277.
[407] See footnote 268.
[408] See footnote 402.
[409] See footnote 403.

takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees approximately 0.5 hours to provide the information at a specific moment.

– This figure is based on the assumption that creditors and credit intermediaries in all Member States would have to modify their framework to take into account specific rules on when the ESIS should be provided.

Member States will face EUR 0.64 million in one-off costs and annual recurring costs of between EUR 0.68 million and EUR 2 million in the event a legislative instrument is chosen. These include the costs already identified under Option 2. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[410] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that all 27 Member States would also have to modify their framework to take into account specific rules on when the ESIS should be provided.

– Annual recurring costs of monitoring and ensuring that the revised ESIS is provided at the specified moment would be between EUR 0.68 million and EUR 2 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

2.8.4. Option 4: Improve the format and content of the ESIS

2.8.4.1. Effectiveness of policy option

Improving the format and content of the ESIS along the lines of the results of the consumer testing undertaken would substantially improve the understandability of pre-contractual information for consumers, thus facilitating the choice of a more appropriate product, particularly for vulnerable consumers with low levels of financial literacy. In social terms, overindebtedness would be reduced and fewer defaults would ensue as a result of consumers choosing more appropriate products.

The confidence of consumers who are better able to understand the ESIS would also increase, further reducing consumer detriment. Confident consumers are also more likely to shop around (predominantly domestically although a small number may also seek to go cross-border) for the most appropriate product and deal, promoting customer mobility and competition.

Improving the format and content of the ESIS is unlikely to foster a level playing field either between creditors themselves or between creditors and credit intermediaries. Furthermore, creditors and credit intermediaries are unlikely to increase the provision of the ESIS simply due to a modified format. Rather a proportion of those already providing the ESIS may decide

[410] See footnote 136.

against updating it and rather stop providing it due to the additional costs but persistent lack of a level playing field.

In conclusion, consumer detriment would be reduced and competition, albeit moderately, enhanced. This would contribute to some improvement in market integration. Social benefits, through fewer defaults, would contribute to both social and financial stability.

2.8.4.2. Impacts of policy option on stakeholders and efficiency

Consumer benefits would primarily take the form of increased consumer confidence arising from the better understandability of the information provided. This increased confidence and the corresponding reduction in consumer detriment would facilitate the choice of a more appropriate product, particularly for vulnerable consumers with low levels of financial literacy. In social terms, overindebtedness would be reduced and fewer defaults would ensue as a result of consumers choosing more appropriate products. Consumers will also face lower search costs as the information provided would be easier to understand and compare as the provision of a revised ESIS reduces the need to search for, review and compare information and literature of the different providers.

Revising the ESIS will bring about incremental one-off costs for creditors in all Member States[411]. Those creditors that are already providing an ESIS[412] or broadly equivalent information will have to bear the costs of revising the ESIS sheet and adjust their systems and processes accordingly. Those creditors that do not currently provide an ESIS sheet will have to incur the one-off and ongoing operational costs of providing the new ESIS.[413]

According to recent research, the EU27 as a whole could realise net benefits of moving to a system whereby a more user-friendly ESIS is provided by creditors and used by consumers to compare mortgage offers from different suppliers.[414]

2.8.4.3. Quantification of costs and benefits

Consumers and society in general will face an aggregate benefit of EUR 311–436 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 2.5–3.5 basis points due to the consumer receiving a more understandable ESIS.

– This is equivalent to mortgages of EUR 311–436 million[415].

[411] Germany and the United Kingdom are special cases. In both countries, the changes to the ESIS will entail one-off costs. However, there are no further costs as Germany has transposed the Code of Conduct into legislation applicable to lenders as well as intermediaries, and in the United Kingdom the ESIS replaces the KFI.

[412] The Code of Conduct is adhered to and implemented by lenders in 20 Member States. Coverage of the Code within the national market varies currently between 90 and 100 % in 14 Member States.

[413] London Economics has carried out a comprehensive cost-benefit analysis. See footnote 136.

[414] See footnote 136.

[415] See footnote 277.

– This figure is based on the assumption that the ESIS would be modified in all 27 Member States.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[416].

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. These benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 185 million in one-off costs and EUR 151 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 81 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 104 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[417] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[418]

– Annual recurring costs are estimated at EUR 107 million for creditors and EUR 44 million for credit intermediaries. Annual recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the additional costs of the action in terms of time spent with the client to obtain all the relevant information. These figures are based on the assumptions that compliance takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees approximately 0.5 hours to provide the information at a specific moment.

– This figure is based on the assumption that the ESIS would have to be modified in all 27 Member States.

Member States will face EUR 0.64 million in one-off costs and annual recurring costs of between EUR 0.68 million and EUR 2 million in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[419] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that the ESIS would have to be modified in all 27 Member States.

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416 See footnote 268.
417 See footnote 402.
418 See footnote 403.
419 See footnote 136.

– Annual recurring costs of monitoring and ensuring that the revised ESIS is provided would be between EUR 0.68 million and EUR 2 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

2.8.5. Option 5: Standardise the Annual Percentage Rate of Charge

2.8.5.1. Option 5.1: Standardise on the basis of a narrow definition

Effectiveness of policy option

Standardisation of the APRC could potentially boost consumer confidence and stimulate consumer mobility. In principle, the computation of clearly understandable and standardised APRC would make mortgage markets more transparent and mortgage products more comparable. While the provision of a narrow APRC makes it easier for consumers to compare mortgage offers from different creditors, thus in theory enhancing consumers' confidence and facilitating customer mobility, a consumer would still have to spend a fair amount of time and resources in undertaking an all-cost inclusive comparison of offers from different creditors. Benefits to consumers would therefore be limited as it would be necessary for consumers to add ancillary costs to a narrow APRC to obtain an APRC that is an appropriate price indicator that can be used for the comparison of mortgage offers.

Standardisation of the APRC across the EU will also eliminate a barrier to cross-border shopping as different APRC definitions, both nationally and cross-border, may give rise to misleading information about the relative competitiveness of product offers in different countries.

On the supply side, standardisation of the APRC will establish a level playing field and fairer competition both domestically and cross-border. Cross-border standardisation will further create fairer competition amongst creditors in different countries provided that a sufficiently narrow definition of the APRC is used so as to guarantee that domestic specificities do not distort the comparison of APRCs. Cross-border activity could rise by 3 %.[420] At the same time, some creditors (domestic and/or foreign) may try to undercut other creditors with a low APRC to attract consumers.[421] This could be done, for example, by tying insurance which is not priced in the APRC or, in the event that an intermediary is being used, not including broker fees in the APRC until the last minute.[422]

Impacts of policy option on stakeholders and efficiency

Consumer benefits would arise principally as a result of being able to shop around more easily to find the best deal. Empirical analysis suggests that, on average across EU27 Member States, the existence of a narrow APRC reduces the percentage of consumers would do not switch mortgage providers relative the percentage of consumers would do not switch

[420] See footnote 136.
[421] See footnote 136.
[422] See footnote 136.

mortgage providers in a market with no APRC by 17 percentage points.[423] However, given the fact that not all costs are included in the APRC, they would continue to face additional search costs in order to collect all the relevant information to make a decision on the best product for their needs. Empirical research undertaken recently appears to show that the costs of obtaining this additional information are very high.[424] A recent study identified that consumers would face net benefits in only four Member States (Lithuania, Latvia, Romania and Slovakia) from the implementation of a narrow APRC definition.[425] These benefits would arise primarily due to the fact that none of these countries currently has a standardised APRC.[426] Consumers in France would face costs through the move from a broad to a narrow APRC. These costs are estimated at EUR 17.3 million in the first year (2009) rising to EUR 100.2 million by 2024.[427]

A move to a narrow APRC definition will entail one-off cost to creditors in all Member States where either a broad APRC is being used and/or the CCD APRC. Only creditors in Belgium, Italy and the United Kingdom would not have to make any changes to the system.[428] Creditors will incur some costs in updating their marketing material and their processes if an APRC definition is adopted that which differs from the one they currently use. However, the cost to creditors of changing the definition is reported by most creditors to be low to moderate[429]. Creditors who move from a broad to APRC to a narrow APRC, such as in France, will also benefit from some ongoing savings as they will need to collect less information. Creditors will also benefit from the cross-border standardisation of the APRC and forecast that cross-border activity could increase by about 3 %.[430]

If the APRC were harmonised on the basis of a narrow definition, only ten Member States would have to pass a law and/or introduce new regulation. The costs to governments and respective regulators are hence likely to be relatively low.

<u>Quantification of costs and benefits</u>

Consumers and society in general will face aggregate benefits of EUR 39–118 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 0.5–1.5 basis points due to the consumer receiving a standardised and understandable APRC.

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423 See footnote 136.

424 See footnote 136.

425 See footnote 136.

426 Since the *Study on the costs and benefits of different policy options for mortgage credit*, see footnote 136, it appears that Romania has decided to introduce the APRC used in the Consumer Credit Directive. As such, only three countries would stand to benefit from the introduction of a standardised APRC based on a narrow definition.

427 See footnote 136.

428 See study (footnote 136) which states that Belgium, Germany, Spain, Italy, Hungary and the United Kingdom would not have to make changes to accommodate a narrow APRC. However, based on information provided to the Commission by Member States, Germany, Spain and Hungary have since decided to apply the definition of the APRC used in the CCD. As such, they would now face costs in implementing a narrow APRC.

429 See footnote 136.

430 See footnote 136.

– This is equivalent to mortgages of EUR 39–118 million[431].

– The benefits incorporate a discount to reflect that in ten Member States (Belgium, Bulgaria, Finland, Greece, Ireland, the Netherlands, Poland, Portugal, Slovakia and the United Kingdom) a narrow APRC or very close to a narrow APRC is currently used for mortgage credit.

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 116 million in one-off costs and EUR 95 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 51 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 65 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[432] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[433] In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[434]

– Annual recurring costs are estimated at EUR 67 million for creditors and EUR 28 million for credit intermediaries. Annual recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the additional costs of the action. These figures are based on the assumptions that compliance takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees approximately 0.5 hours to provide the information at a specific moment. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[435]

– The benefits incorporate a discount to reflect that in ten Member States (Belgium, Bulgaria, Finland, Greece, Ireland, the Netherlands, Poland, Portugal, Slovakia and the United Kingdom) a narrow APRC or very close to a narrow APRC is currently used for mortgage credit.

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[431] See footnote 277.

[432] See footnote 402.

[433] See footnote 403.

[434] Latvia, Lithuania, Romania (NB. according to information provided to Commission services, Romania intends to apply the CCD to mortgage credit in the area of the APRC) and Slovakia have no APRC at present time, see footnote 136.

[435] See footnote 434.

Member States will face EUR 0.4 million in one-off costs and annual recurring costs of between EUR 0.4 million and EUR 1 million in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.4 million. This is based on the assumption in a recent study[436] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that 17 Member States would have to modify their frameworks.

– Annual recurring costs of monitoring and enforcing a new framework would be between EUR 0.4 million and EUR 1 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[437]

– The benefits incorporate a discount to reflect that in ten Member States (Belgium, Bulgaria, Finland, Greece, Ireland, the Netherlands, Poland, Portugal, Slovakia and the United Kingdom) a narrow APRC or very close to a narrow APRC is currently used for mortgage credit.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

An external study also calculated the costs and benefits of standardising the APRC.[438] It concluded that the net impact of standardising the APRC based on a narrow definition would result in costs for the EU27 of EUR 136 million over a period of 15 years (2009–2024).[439] This figure is based on the following assumptions[440]:

– The APRC is the appropriate price indicator to use when comparing mortgage offers.

– It is necessary to add all ancillary costs to a narrow ARPC to obtain an all cost inclusive APRC which allows for proper comparison. This requires time and the value of time saved by consumers not having to undertake such an analysis. The time saved by consumers is valued at the average industrial wage.

– The baseline assumption is that each ESIS based on a narrow APRC will require 60 minutes of the borrowers' time to develop a price that takes into account all costs. The 60 minutes loosely reflects discussions with stakeholders.

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436 See footnote 136.

437 See footnote 434.

438 See footnote 136.

439 See footnote 136. However, it needs to be noted that this calculated figure is based on and sensitive to various assumptions such as time spent by a borrower assessing the cost of a particular mortgage offer or the costs faced by lenders.

440 The description of the detailed assumptions is extracted from *Study on the costs and benefits of different policy options for mortgage credit*, see footnote 136. Further detailed information on the modelling is also available there.

– The benefits in time saved by a potential borrower as a result of a move from a narrow to CCD type APRC are equal to 50 % if the savings of a move to a broad APRC. This is due to the fact that the CCD APRC does not include notary costs whereas the broad APRC does. The 50 % assumption loosely reflects discussions with stakeholders.

– A move to a narrow APRC will entail one-off costs to lenders in all Member States where either a broad APRC is being used or a narrow APRC with some elements of a broad APRC is being used. Lenders who move from a broad APRC to a narrow APRC will also benefit from some ongoing savings as they will need to collect less information. The savings are the mirror image of the costs that lenders would incur if they have to move from a narrow to a CCD type or broad APRC.

– A move to a CCD type or broad APRC will entail one-off costs to lenders in all Member States with a narrow APRC. They will also incur some annual recurring costs to collect the additional information that is required for a broad APRC.

– Other assumptions for calculating the lenders costs include: number of working hours per year – 1950; number of man days required to set up a new system – 2; ratio of capital to labour costs in a one-time set-up – 2; man days required for ongoing information gathering under a new system – 0.5 man days per year; time necessary to collect the ancillary information required for the production of an APRC specific to the EIS – 30 minutes.

– A discount rate of 5.5 % on all costs and benefits to all stakeholders is used to compute the NPV.

2.8.5.2. Option 5.2: Standardise on the basis of Article 19 of the CCD

<u>Effectiveness of policy option</u>

In principle, the computation of clearly understandable and standardised APRC would make mortgage markets more transparent and mortgage products more comparable. The provision of a standardised APRC based on the CCD would make it easier for consumers to compare mortgage offers from different creditors, thus in theory enhancing consumers confidence and facilitating customer mobility. However, some additional search costs would remain for consumers, particularly as regard those costs not levied by lender for its own benefit, such as taxes. Consequently, consumer confidence is likely to rise in tandem with the broadness of the APRC. The same is likely to be true for customer mobility as better price information typically is also expected to facilitate customer mobility. It should also be considered that the broader the APRC, the later in the mortgage granting process the APRC is actually produced since all additional costs would may not be known until a late stage in the process.

Standardisation of the APRC across the EU will also eliminate to some extent a barrier to consumers shopping cross-border as different APRC definitions, both nationally and cross-border. On the one hand, the same definitions would be used across the EU, enhancing cross-border comparability. Moreover, although not the main objective and of less importance, the APRC based on the CCD definition as such a definition would also provide for consistency between mortgage and consumer credit, which in instance where the consumer has to choose between a consumer credit and a mortgage credit, for example, when renovating a property.

On the other hand, there is a risk that the broader the APRC, the higher the risk of misleading information about the relative competitiveness of product offers in different countries.

Cross-border standardisation will further create fairer competition amongst creditors in different countries and may therefore stimulate cross-border lending. However, the broader the APRC, the greater the risk that different cost bases are used in different Member States. Creditors in Member States with few obligatory costs to be included in the APRC would therefore be at a competitive advantage vis-à-vis those with a wider cost base.

Impacts of policy option on stakeholders and efficiency

Consumer benefits would arise principally as a result of being able to shop around more easily to find the best deal. Empirical analysis suggests that, on average across EU27 Member States, the existence of a APRC based on the CCD reduces the percentage of consumers who would not switch mortgage providers relative the percentage of consumers would do not switch mortgage providers in a market with no APRC by between 17 and 23 percentage points.[441] Consumers would save time as they do not need to collect additional costs and calculate the more cost-inclusive measure. However, they would still need to search for information on costs excluded from the CCD-type APRC, such as notary costs and taxes. Empirical research undertaken recently appears to show that these costs of additional information are very high.[442] In this context, a recent study identified that consumers would only face net benefits across most of Europe; the exception being France.[443]

If an APRC definition is adopted that which differs from the one they currently use, creditors will incur one-off costs in updating their systems, processes and marketing material. Moreover, gathering information about costs which are not under the control of the creditor will lead to annual recurring costs for the industry in all Member States that use currently a narrower definition. This would be expensive.[444]

The adoption of a CCD-type definition is somewhat less costly for creditors than a broad definition as all creditors will incur one-off costs[445] and all creditors will incur part of the annual recurring costs they would face under a broad APRC.[446] However, based on the information provided to the Commission, 11 Member States (Austria, Cyprus, Denmark, Estonia, Germany[447], Hungary, Malta, Romania, Slovenia, Spain[448] and Sweden) have already decided to apply to mortgage credit the calculation method outlined in Article 19 and Annex 1 of the CCD.[449] Furthermore, 13 Member States (Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Romania, Slovenia, Spain[450] and Sweden) have decided to apply the definition of the APRC as set out in Article 3(g)–(i) of the CCD to mortgage credit. The incremental costs to creditors in those countries, is therefore likely to be minimal or non-

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441 See footnote 136.
442 See footnote 136.
443 See footnote 136.
444 See footnote 136.
445 See footnote 136. All creditors except the French would incur costs for moving to a broad APRC as the French creditors already have a broad APRC. According however to information provided to the Commission services, France will apply the CCD cost base to mortgage credit.
446 See footnote 136.
447 Except for costs for securities.
448 See footnote 224.
449 See footnote 254.
450 See footnote 224.

existent. Furthermore, creditors will also benefit from the cross-border standardisation of the APRC and forecast that cross-border activity could increase by about 3 %.[451]

If the APRC were harmonised on the basis of the definition contained in the CCD, those Member States[452] who have not already done so would have to pass a law and/or introduce new regulation. The costs to governments and respective regulators are likely to be moderate.[453]

Table 10 provides an overview of the annual impacts on different stakeholders in selected Member States.

451 See footnote 136.

452 In a survey, a number of Member States (Denmark, Germany, Estonia, Spain, France, Italy, Cyprus, Hungary, Malta, Austria, Romania, Slovenia and Sweden) reported that they intend to apply the Article 19 of the CCD to mortgage credit.

453 See footnote 136.

Table 10: Annual impact of Option 5.2 by country and stakeholder group, 2009–2013 and 2024 (million EUR of local currency)

Country	Stakeholder group	2009	2010	2011	2012	2013	...2024
Belgium	Consumers	2	2.4	3.7	4.3	5.9	10.8
	Lenders	-22.7	-18.2	-19.9	-20.8	-23	-33.1
	Intermediaries	-0.2	-0.2	-0.3	-0.4	-0.5	-1
	Independent control body	-1.4	-1.4	-1.4	-1.4	-1.5	-1.9
	Government	-4.6	-3.7	-4.1	-4.2	-4.7	-6.8
	Total, society	-20.8	-16.1	-16.5	-16.8	-17.6	-23.3
Denmark	Consumers	4.3	4.9	6.8	7.9	10.8	19.6
	Lenders	-6.3	-7	-9.4	-10.8	-14.6	-26.5
	Intermediaries	-0.4	-0.5	-0.6	-0.7	-1	-1.9
	Independent control body	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
	Government	-1.9	-2.1	-2.8	-3.2	-4.4	-8
	Total, society	-2.4	-2.5	-3.2	-3.6	-4.8	-8.9
Spain	Consumers	28	32.5	63.4	73.2	100.5	192.3
	Lenders	-50.8	-42.6	-53.1	-56.6	-66.3	-103.8
	Intermediaries	-1.9	-2.2	-4.3	-4.9	-6.8	-13.2
	Independent control body	-2.9	-2.9	-2.9	-2.9	-3	-3.8
	Government	-9	-7.6	-9.7	-10.5	-12.4	-19.9
	Total, society	-24.7	-12.3	6	11.6	27.4	75.3
France	Consumers	21.1	24.4	39.4	45.5	62.3	117.6
	Lenders	-21.5	-21.6	-31	-34.9	-45.4	-80.4
	Intermediaries	-1.8	-2.1	-3.4	-4	-5.5	-10.6
	Independent control body	-0.6	-0.6	-0.6	-0.6	-0.6	-0.8
	Government	-2.8	-2.9	-4.1	-4.7	-6.1	-10.9
	Total, society	-2.3	0.7	5	6.7	11.4	26.6
Germany	Consumers	0	0	0	0	0	0
	Lenders	-5.6	0	0	0	0	0
	Intermediaries	0	0	0	0	0	0
	Independent control body	0	0	0	0	0	0
	Government	0	0	0	0	0	0
	Total, society	-5.6	0	0	0	0	0
Netherlands	Consumers	8.3	9.6	14.8	17.1	23.3	42.4
	Lenders	-19.2	-18.8	-25.4	-28.3	-36.5	-63.4
	Intermediaries	-0.6	-0.7	-1.2	-1.3	-1.8	-3.6
	Independent control body	-0.6	-0.6	-0.6	-0.6	-0.6	-0.8
	Government	-1.8	-1.8	-2.4	-2.7	-3.4	-6
	Total, society	-11.5	-9.9	-11.7	-12.6	-15	-24.5
Hungary	Consumers	1.3	1.4	2.3	2.6	3.4	5.8
	Lenders	-1.2	-1	-1.3	-1.4	-1.7	-2.6
	Intermediaries	-0.1	-0.1	-0.2	-0.2	-0.3	-0.5
	Independent control body	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
	Government	-0.3	-0.2	-0.3	-0.3	-0.4	-0.6
	Total, society	0	0.3	0.8	0.9	1.4	2.7
United Kingdom	Consumers	0	0	0	0	0	0
	Lenders	-2.3	0	0	0	0	0
	Intermediaries	0	0	0	0	0	0
	Independent control body	0	0	0	0	0	0
	Government	0	0	0	0	0	0
	Total, society	-2.3	0	0	0	0	0

Source: Costs and benefits of different policy options for mortgage credit, London Economics, November 2009, p. 149.
Note: "–" indicates a negative NPV.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 124–229 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 1–2 basis points due to the consumer receiving a more understandable ESIS.

– This is equivalent to mortgages of EUR 124–229 million[454].

– The benefits incorporate a discount to reflect that in 13 Member States (Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Romania, Slovenia, Spain[455] and Sweden) intend to apply the CCD APRC to mortgage credit.

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 96 million in one-off costs and EUR 78 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 42 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 54 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[456] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[457] In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[458]

– Annual recurring costs are estimated at EUR 55 million for creditors and EUR 23 million for credit intermediaries. Annual recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the additional costs of the action in terms of time spent with the client to obtain all the relevant information. These figures are based on the assumptions that compliance takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees

[454] See footnote 277.
[455] See footnote 224.
[456] See footnote 402.
[457] See footnote 403.
[458] See footnote 434.

approximately 0.5 hours to provide the information at a specific moment. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[459]

– The one-off and annual recurring costs incorporate a discount to reflect that in 13 Member States (Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Romania, Slovenia, Spain[460] and Sweden) intend to apply the CCD APRC to mortgage credit.

Member States will face EUR 0.33 million in one-off costs and annual recurring costs of between EUR 0.35 million and EUR 1 million in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.33 million. This is based on the assumption in a recent study[461] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that the APRC framework in 14 Member States would need modification.

– Annual recurring costs of monitoring and enforcing the new framework is provided would be between EUR 0.35 million and EUR 1 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[462]

– These figures incorporate a discount to reflect that in 13 Member States (Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Romania, Slovenia, Spain[463] and Sweden) intend to apply the CCD APRC to mortgage credit.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

An external study also calculated the costs and benefits of standardising the APRC.[464] It concluded that the net impact of standardising the APRC based on a CCD-type definition would result in benefits for the EU27 of EUR 5 million over a period of 15 years (2009-2024).[465] This figure is based on the following assumptions[466]:

– The APRC is the appropriate price indicator to use when comparing mortgage offers.

– It is necessary to add all ancillary costs to a narrow ARPC to obtain an all cost inclusive APRC which allows for proper comparison. This requires time and the

459 See footnote 434.
460 See footnote 224.
461 See footnote 136.
462 See footnote 434.
463 See footnote 224.
464 See footnote 136.
465 See footnote 439.
466 See footnote 440.

value of time saved by consumers not having to undertake such an analysis. The time saved by consumers is valued at the average industrial wage.

– The baseline assumption is that each ESIS based on a narrow APRC will require 60 minutes of the borrowers' time to develop a price that takes into account all costs. The 60 minutes loosely reflects discussions with stakeholders.

– The benefits in time saved by a potential borrower as a result of a move from a narrow to CCD type APRC are equal to 50 % if the savings of a move to a broad APRC. This is due to the fact that the CCD APRC does not include notary costs whereas the broad APRC does. The 50 % assumption loosely reflects discussions with stakeholders.

– A move to a narrow APRC will entail one-off costs to lenders in all Member States where either a broad APRC is being used or a narrow APRC with some elements of a broad APRC is being used. Lenders who move from a broad APRC to a narrow APRC will also benefit from some ongoing savings as they will need to collect less information. The savings are the mirror image of the costs that lenders would incur if they have to move from a narrow to a CCD type or broad APRC.

– A move to a CCD type or broad APRC will entail one-off costs to lenders in all Member States with a narrow APRC. They will also incur some annual recurring costs to collect the additional information that is required for a broad APRC.

– Other assumptions for calculating the lenders costs include: number of working hours per year – 1950; number of man days required to set up a new system – 2; ratio of capital to labour costs in a one-time set-up – 2; man days required for ongoing information gathering under a new system – 0.5 man days per year; time necessary to collect the ancillary information required for the production of an APRC specific to the EIS – 30 minutes.

A discount rate of 5.5 % on all costs and benefits to all stakeholders is used to compute the NPV.

2.8.5.3. Option 5.3: Standardise on the basis of a broad definition

Effectiveness of policy option

In principle, the computation of clearly understandable and standardised APRC would make mortgage markets more transparent and mortgage products more comparable. The provision of a standardised APRC based a broad definition would make it even easier for consumers to compare mortgage offers from different creditors, thus in theory enhancing consumers confidence and facilitating customer mobility. A broad APRC (in contrast to a narrow or CCD-based APRC) would facilitate comparison and not entail additional costs for consumers (in terms of searching for and analysing other costs). Consequently, consumer confidence is likely to be boosted even further than with a CCD-based APRC. The same is likely to be true for customer mobility as better price information typically is also expected to facilitate customer mobility. It should also be considered that the broader the APRC, the later in the mortgage granting process the APRC is actually produced since all additional costs would may not be known until a late stage in the process.

Standardisation of the APRC across the EU will also eliminate to some extent a barrier to consumers shopping cross-border as different APRC definitions, both nationally and cross-border. On the one hand, the same definitions would be used across the EU, enhancing cross-border comparability. On the other hand, there is a risk that the broader the APRC, the higher the risk of misleading information about the relative competitiveness of product offers in different countries. In particular, a broad APRC would not eliminate the risk that when shopping cross-border consumers do not compare like with like. Legal requirements for certain activities related to establishing the surety on the property (but not under the creditor's control) and/or their costs may vary.[467] Therefore, it is possible that the APRC across the border could appear to be lower than in a borrower's home country if legal costs vary. Yet, when the consumer wants to avail herself/himself of the cheaper cross-border offer, the apparent cost advantage may vanish because the foreign creditor will have to pay the domestic legal cost to establish the surety on the domestic property.

Cross-border standardisation will further create fairer competition amongst creditors in different countries and may therefore stimulate cross-border lending. However, the broader the APRC, the greater the risk that different cost bases are used in different Member States. Creditors in Member States with few obligatory costs to be included in the APRC would therefore be at a competitive advantage vis-à-vis those with a wider cost base.

Impacts of policy option on stakeholders and efficiency

Consumer benefits would arise principally as a result of being able to shop around more easily to find the best deal. The broad APRC would facilitate this by reducing the time and resources required to shop around, particularly cross-border. Empirical analysis suggests that, on average across EU27 Member States, the existence of a APRC based on the CCD reduces the percentage of consumers who would not switch mortgage providers relative the percentage of consumers would do not switch mortgage providers in a market with no APRC by 23 percentage points.[468] Consumers would save time as they do not need to collect additional costs and calculate the more cost-inclusive measure. Empirical research undertaken recently appears to show that these costs of additional information are very high.[469] In this context, a recent study identified that consumers would only face net benefits across most of Europe.[470]

If an APRC definition is adopted that differs from the one they currently use, thus in all Member States, creditors will incur one-off costs in updating their systems, processes and marketing material. Moreover, gathering information about costs which are not under the control of the creditor will lead to annual recurring costs for the industry in all Member States that use currently a narrower definition. This would be expensive.[471] These annual recurring costs would be higher than for an APRC based on the CCD definition as more information will need to be collected to calculate the measure.

With the adoption of a broad definition, all creditors would incur one-off costs and annual recurring costs to collect the additional information required to calculate the APRC.[472] These costs would be far higher than under the other options. Furthermore, creditors will also benefit

467 See footnote 136.
468 See footnote 136.
469 See footnote 136.
470 See footnote 136.
471 See footnote 136.
472 See footnote 136.

from the cross-border standardisation of the APRC and forecast that cross-border activity could increase by about 3 %.[473]

As far as costs to governments and regulators are concerned, practically all Member States which currently have an APRC defined in law or in industry agreement/code, would have to modify their current approach if a broad definition is adopted.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 187–311 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 1.5–2.5 basis points due to the consumer receiving a more understandable ESIS.

– This is equivalent to mortgages of EUR 187–311 million[474].

– This is based on the assumption that all 27 Member States would have to modify their framework for calculating the APRC. This differs from the calculations made by London Economics described below which assumes that France has a broad APRC and thus would not face any costs/benefits.

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 185 million in one-off costs and EUR 151 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 81 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 104 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[475] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[476] In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[477]

473 See footnote 136.
474 See footnote 277.
475 See footnote 402.
476 See footnote 403.
477 See footnote 434.

– Annual recurring costs are estimated at EUR 107 million for creditors and EUR 44 million for credit intermediaries. Annual recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the additional costs of the action in terms of time spent with the client to obtain all the relevant information. These figures are based on the assumptions that compliance takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees approximately 0.5 hours to provide the information at a specific moment. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[478]

– This is based on the assumption that all 27 Member States would have to modify their framework for calculating the APRC. This differs from the calculations made by London Economics described below which assumes that France has a broad APRC and thus would not face any costs/benefits.

Member States will face EUR 0.64 million in one-off costs and annual recurring costs of between EUR 0.68 million and EUR 2 million in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[479] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that the ESIS would have to be modified in all 27 Member States.

– Recurring costs of monitoring and enforcing the new framework would be between EUR 0.68 million and EUR 2 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[480]

– This is based on the assumption that all 27 Member States would have to modify their framework for calculating the APRC. This differs from the calculations made by London Economics described below which assumes that France has a broad APRC and thus would not face any costs/benefits.

Benefits are also expected on Member States’ side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

An external study also calculated the costs and benefits of standardising the APRC.[481] It concluded that the net impact of standardising the APRC based on a broad definition would

[478] See footnote 434.
[479] See footnote 136.
[480] See footnote 434.
[481] See footnote 136.

result in benefits for the EU27 of EUR 176 million over a period of 15 years (2009–2024).[482] This figure is based on the following assumptions[483]:

– The APRC is the appropriate price indicator to use when comparing mortgage offers.

– It is necessary to add all ancillary costs to a narrow ARPC to obtain an all cost inclusive APRC which allows for proper comparison. This requires time and the value of time saved by consumers not having to undertake such an analysis. The time saved by consumers is valued at the average industrial wage.

– The baseline assumption is that each ESIS based on a narrow APRC will require 60 minutes of the borrowers' time to develop a price that takes into account all costs. The 60 minutes loosely reflects discussions with stakeholders.

– The benefits in time saved by a potential borrower as a result of a move from a narrow to CCD type APRC are equal to 50 % if the savings of a move to a broad APRC. This is due to the fact that the CCD APRC does not include notary costs whereas the broad APRC does. The 50 % assumption loosely reflects discussions with stakeholders.

– A move to a narrow APRC will entail one-off costs to lenders in all Member States where either a broad APRC is being used or a narrow APRC with some elements of a broad APRC is being used. Lenders who move from a broad APRC to a narrow APRC will also benefit from some ongoing savings as they will need to collect less information. The savings are the mirror image of the costs that lenders would incur if they have to move from a narrow to a CCD type or broad APRC.

– A move to a CCD type or broad APRC will entail one-off costs to lenders in all Member States with a narrow APRC. They will also incur some annual recurring costs to collect the additional information that is required for a broad APRC.

– Other assumptions for calculating the lenders costs include: number of working hours per year – 1950; number of man days required to set up a new system – 2; ratio of capital to labour costs in a one-time set-up – 2; man days required for ongoing information gathering under a new system – 0.5 man days per year; time necessary to collect the ancillary information required for the production of an APRC specific to the EIS – 30 minutes.

– A discount rate of 5.5 % on all costs and benefits to all stakeholders is used to compute the NPV.

2.8.6. *Option 6: Additional pre-contractual information*

2.8.6.1. Effectiveness of policy option

The ESIS contains exclusively information on the mortgage credit product. For the consumers, however, information on the actor selling the mortgage may be useful or even necessary to base the product choice on sufficient and appropriate information. Additional

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482 See footnote 439.
483 See footnote 440.

information would therefore reduce information asymmetries between the provider and consumer. Being informed about the incentive structures and market coverage of the selling actor will help reduce the risk of mis-selling due to conflicts of interest and therefore reduce the risk of consumer detriment. This means that the risk of ending up with an unsuitable and potentially unsustainable product could be reduced, and so could the instances of overindebtedness and defaults. The reduced risk of mis-selling would also have social impacts in terms of a lower level of defaults and foreclosures, leading to benefits in terms of social and financial stability.

The proposed additional pre-contractual information is also likely to boost market transparency and thus consumer confidence. Greater transparency could also contribute to enhanced customer mobility as consumers shop around, both domestically and cross-border, between different actors with a greater awareness of possible undue influences on the products that they are being offered and confident that they will receive similar information across the EU. Greater customer mobility and reduced information asymmetries would also contribute to a creating a more competitive and efficient single market.

2.8.6.2. Impacts of policy option on stakeholders and efficiency

In terms of benefits, consumers would face a reduced risk of mis-selling which would have social impacts in terms of a lower level of defaults and foreclosures. It is estimated that this translates to a positive impact on the overall financial and social stability. Consumers will face lower search costs as they would be able to choose a more appropriate intermediary, facilitating mobility and competition. Consumers themselves would not face any direct costs, unless the costs faced by other actors were passed onto them. This represents an estimated benefit of between EUR 124–249 million.

Credit intermediaries and creditors, if applicable, would have to bear the costs of developing and producing the relevant information. It can be assumed that the one-off costs (training, adaptation of systems/SOPs, documentation time) incurred by creditors and credit intermediaries in terms of developing and implementing systems related to additional disclosures will be approximately EUR 185 million. They will also face ongoing annual operational costs (approximately EUR 151 million), which will amount to the staff time that will need to be spent to make the disclosures required. The aforementioned costs would be offset somewhat by the potential for (i) operational optimisations triggered by the likelihood of increased competition coming from the facilitation of cross-border business and (ii) increased revenue generated from the growth in consumer confidence and willingness to transact.

Member States would face one-off costs of designing and adapting legislation or regulatory guidance as well as ongoing supervisory costs, particularly if a binding instrument is chosen. One-off set up costs are expected to amount to EUR 0.64 million and annual recurring costs to EUR 0.68 million and EUR 2 million. These mainly relate to the introduction and enforcement of the new requirements.

2.8.6.3. Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 124–249 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 1–2 basis points due to the consumer receiving additional information.

– This is equivalent to mortgages of EUR 124–249 million[484].

– This is based on the assumption that all 27 Member States would have to introduce or modify rules on the provision of additional information.

Consumers will also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face approximately EUR 185 million in one-off costs and EUR 151 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs for creditors are estimated at EUR 81 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. One-off costs for credit intermediaries is estimated at EUR 104 million for the establishment of new IT systems, the development of new standard operating procedures and staff training. These figures are based on the assumptions that 20 % of staff of creditors and 80 % of staff of credit intermediaries will have to undergo 2-hour training.[485] It is also based on the assumption that adaption of procedures and IT systems will take 30 man days per credit institution and 30 man days per credit intermediary.[486] In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[487]

– Recurring costs are estimated at EUR 107 million for creditors and EUR 44 million for credit intermediaries. Recurring costs reflect the compliance costs faced by creditors and credit intermediaries as well as the additional costs of the action in terms of time spent with the client to obtain all the relevant information. These figures are based on the assumptions that compliance takes approximately 0.5 hours per institution and approximately 10 % of mortgage transactions are verified. Furthermore, it is assumed that it will take employees approximately 0.5 hours to provide the information at a specific moment. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[488]

– This is based on the assumption that all 27 Member States would have to introduce or modify rules on the provision of additional information.

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[484] See footnote 277.
[485] See footnote 402.
[486] See footnote 403.
[487] See footnote 434.
[488] See footnote 434.

Member States will face EUR 0.64 million in one-off costs and recurring costs of between EUR 0.68 million and EUR 2 million in the event a legislative instrument is chosen. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[489] that each Member State will incur one-off costs of approximately EUR 23 529. This is based on the assumption that all 27 Member States would have to introduce or modify rules on the provision of additional information.

– Recurring costs of monitoring and enforcing the new framework would be between EUR 0.68 million and EUR 2 million. This reflects the fact that it would take approximately between 1 and 3 hours per institution to ensure that the rules are followed. In practice, incremental costs are likely to be lower than the figures stated as all but three Member States already have a harmonised APRC for mortgage credit.[490] This is based on the assumption that all 27 Member States would have to introduce or modify rules on the provision of additional information.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

2.8.7. Comparison of options

While Table 11 assesses the effectiveness and efficiency of the individual policy options, it is important to underline that the different policy options are not necessarily mutually exclusive and may be combined to have a more effective and efficient set of measures which fully address problems outlined and objectives set.

Clear, understandable and comparable information is an essential element in responsible lending and borrowing. The 'Do nothing' option (Option 1) would neither address any of the problems identified above nor achieve any of the objectives of the initiative. Furthermore, doing nothing does not entail any costs or benefits to stakeholders as no changes for the actors in the market. Option 1 can therefore be rejected.

489 See footnote 136.
490 See footnote 434.

Table 11: Pre-contractual information – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Provide consumers with the means to make informed decisions in sufficient time to enable them to shop around	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1: Do nothing	0	0	0	0	0	0	0
2: Ensure that consumers receive the ESIS	✓	✓	✓	✓	✓✓	0/✓	✓
3: Ensure that the ESIS is provided in time to enable consumers to shop around							
3.1: Principles-based requirement	0/✓	✓	✓	0/×	0	0/✓	0/✓
3.2: Specify a deadline for the provision of information	✓	✓	✓✓	0	✓	0/✓	✓
4: Improve the format and content of the ESIS	✓✓✓	✓✓✓	✓✓	0	0	✓✓	✓✓
5: Standardise the APRC							
5.1: Harmonisation on the basis of a narrow definition	✓	✓	✓	✓✓	✓✓	✓	✓
5.2: Standardise on the basis Article 19 of the CCD	✓✓	✓✓	✓✓	✓✓✓	✓✓	✓	✓✓✓
5.3: Standardise on the basis of a broad definition	✓✓✓	✓✓✓	✓✓✓	✓✓	✓	✓	✓✓
6: Additional pre-contractual information	✓✓	0	✓	✓✓	0	0	✓✓

In terms of ensuring that the information provided is complete, clear and easy for consumers to understand, Option 4 (revising the content and format of the ESIS) has the greatest impact in terms of improving the quality of the information provided. This would enable consumers to understand the features and risks connected with a certain mortgage product and to use this knowledge to compare products and make an informed choice. Option 6 (additional information) is also effective in providing important information on the actor which is not contained in the ESIS. Option 4, improving the format and content of the ESIS, can be combined with either Option 5.2 or 5.3 on the APRC and/or Option 6 (additional information) to ensure that consumers receive the complete, clear and easily understandable information that they require.

A key element in ensuring that consumers receive appropriate information on mortgage products is that they actually receive appropriate information from the creditor or credit intermediary. This can be done by ensuring that all interlocutors, be they creditors or credit intermediaries, provide all the relevant information. While simply ensuring that they will receive the ESIS (Option 2), would not solve all the problems relating to the content and/or format or general understandability of the information provided, it could ensure that consumers actually receive the information. Option 2 would reduce consumer detriment and stimulate customer mobility and cross-border lending. Option 2 would also potentially help create a more level playing field between creditors across the EU as well as between creditors and credit intermediaries.

Option 3 (3.1 and 3.2) would enable consumers to receive the information (Option 2) in sufficient time to be able to use the information to understand the product and shop around for the best deal. While Option 3.1 would be flexible enough to ensure that national specificities were taken into account, there would also be risks that it would be too flexible, thus creating an unlevel playing field between different actors and leading to no effective change in the current situation. For consumers, uncertainty surrounding when they would actually receive the ESIS would also be detrimental to consumer confidence and shopping around. Option 3.2 (i.e. Option 2 coupled with a specific deadline for the provision of information) appears therefore to be a superior solution.

To ensure that information is comparable both nationally and across the EU, a clearly defined Annual Percentage Rate of Charge is an essential tool. Options 5.1, 5.2, 5.3 have been found to vary in their effectiveness to deliver the envisaged objectives. While Option 5.1, the narrow APRC definition, would be effective in terms of eliminating barriers to cross-border mobility, consumers would need to add ancillary costs to calculate a measure that is an appropriate price indicator. Options 5.2 and 5.3, adopting a CCD-type or broad APRC, have been found to be more effective in achieving the objectives. Option 5.2 has some advantages in terms of encouraging cross-border mobility and creating a level playing field with consumer credit. Option 5.3 has the advantage of reducing consumer search costs and improving confidence, however has a risk of misleading consumers about the best offer and could lead to unfair competition between creditors and credit intermediaries at the cross-border level. Consequently, Option 5.2 (CCD-type) is the preferred option for the APRC.

Table 12: Pre-contractual information – Impacts on main stakeholders

Stakeholders/ Policy options on ESIS	Consumers	Creditor	Credit intermediaries	Member States
1: Do nothing	0	0	0	0
2: Ensure that consumers receive the ESIS	✓	✓	✓	×
3: Ensure that the ESIS is provided in sufficient time to enable consumers to shop around				
3.1: Principles-based requirement	✓	×	×	×
3.2: Specify a moment/deadline for the provision of information	✓✓	×××	×××	×
4: Improve the format and content of the ESIS	✓✓✓	××	0	×
5: Standardise the APRC				
5.1: Standardise on the basis of a narrow definition	×	✓	0	×
5.2: Standardise on the basis of Article 19 of the CCD	✓✓	××	0	×
5.3: Standardise on the basis of a broad definition	✓✓✓	×××	0	×
6: Additional pre-contractual information	✓✓	×	××	×

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

In conclusion, a combination of Options 3.2 (specify a deadline for the provision of the ESIS), 4 (improve the content and format of the ESIS), 5.2 (standardisation of the APRC based on the CCD definition) and 6 (provision of additional information) have been identified to be most effective to tackle the problems in the market and achieve the objectives of the initiative.

This combination would bring substantial benefits to consumers and society at large as a result of consumers purchasing the most appropriate product for their needs and being less likely to being overindebted and default. As such, these benefits, which are estimated at ranging from EUR 39 million to EUR 611 million depending on the policy option, should be viewed as for society as a whole. The benefits of a combination of policy options are not assumed to be cumulative as many of the borrowers impacted by one particular policy option would also be impact under another option and as such could not be impacted twice. Consumers would also benefit from the increased comparability of offers in terms of increased customer mobility and increased competition between providers, leading to the availability of better deals.

One-off costs to creditors and credit intermediaries are also not cumulative. Costs for training are included under each policy option however in practice only one training session of 2 hours is required rather than six. Similarly, synergies in adapting IT and systems changes will be available. Consequently, one-off costs will be lower than the sum of individual parts. Annual recurring costs for creditors and credit intermediaries will amount to the staff time that will need to be spent to make the disclosures required. Synergies in collecting and providing the information area also likely, as such these costs are likely to be overestimated. There will also be benefits to creditors and credit intermediaries in the form of increased opportunities for economies of scale and scope both domestically and cross-border.

Member States will also face costs. However, one-off costs are unlikely to be much higher than EUR 0.6 million. This is because the costs of introducing rules, in the event of a legislative instrument, would not be cumulative as the costs of introducing one policy option would be similar to the costs of introducing more than one policy option. Recurring costs are also unlikely to be cumulative in this instance.

Table 13: Pre-contractual information – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 1	Option 2	Option 3.1	Option 3.2	Option 4	Option 5.1	Option 5.2	Option 5.2	Option 6
Consumer/ social benefits									
Reduction in defaults (value of mortgages)[491]	0	150–300	150–300	337–611	311–436	39–118	124–229	187–311	124–229
Increased customer mobility	0	Not quantifiable	0	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable
Creditor/ credit intermediary benefits									
Efficiency savings	0	Not quantifiable	0	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable
Total EU costs (million EUR)	Option 1	Option 2	Option 3.1	Option 3.2	Option 4	Option 5.1	Option 5.2	Option 5.2	Option 6
Creditor/ credit intermediary costs									
One–off	0	90	90	185	185	116	96	185	185
Recurring	0	72	72	151	151	95	78	151	151
Member State costs									
One–off	0	0.3	0.6	0.6	0.6	0.4	0.3	0.6	0.6
Recurring	0	0.3–1	0.7–2	0.7–2	0.7–2	0.4–1	0.4–1	0.7–2	0.7–2

In addition to the analysis conducted by Commission services described above, a comprehensive external cost-benefit analysis for the combined impact of Options 2, 3 and 4 has been undertaken.[492] The analysis concluded that there could be substantial benefits, in the event a legislative instrument is chosen, in moving to a system with a user friendly ESIS is provided by all actors in a timely manner.[493] These benefits are estimated at EUR 219 million over 15 years (2009–2024) in the event of legally binding rules.[494] The study forecasts however that the EU could face costs of EUR 8.8 million over 15 years (2009–2024) in the event of self-regulatory rules.[495] In terms of the APRC, the study forecasts that Options 5.1, 5.2 and 5.3 will all entail one-off costs to creditors in all Member States that currently use a different definition. The annual recurring costs for creditors increase with the broadness of the definition while the opposite is true for the benefits for the consumers. Under Option 5.1, the

491 See footnote 281.
492 See footnote 136.
493 See footnote 136.
494 See footnote 136.
495 See footnote 136.

narrow APRC definition, consumers would be worse off in most Member States as they would need to calculate themselves the measure to compare mortgages appropriately. The net benefits of this option are therefore negative. In contrast, Options 5.2 and 5.3 have been identified to deliver positive net benefits. Although the net benefits has been found to be higher for Option 5.3, the broad APRC, the preferred policy option is Option 3, the CCD-type definition of the APRC, due to its effectiveness with regard to encouraging cross-border mobility as well as the consistency between consumer and mortgage credit, together with the fact that some Member States have already transposed the relevant articles of the CCD to mortgage credit.

While the external cost-benefit analysis shows that more benefits are available over the period 2009–2015 from choosing Option 5.3, Option 5.2 remains the preferred option. Option 5.2 is more effective in promoting cross-border mobility as it allows a better comparison of the APRC, due to the fact that it includes costs, such as notary fees, which vary from Member State to Member State. Option 5.3 has the advantage of reducing consumer search costs and improving confidence, however has a risk of misleading consumers about the best offer and could lead to unfair competition between creditors and credit intermediaries at the cross-border level.

In conclusion, and taking into account both the analysis by Commission services and the external cost-benefit analysis, the preferred option is a combination of Options 2 (ensure that consumers receive the ESIS), 3.2 (specify a deadline for the provision of the ESIS), 4 (improve the content and format of the ESIS), 5.2 (standardisation of the APRC based on the CCD definition) and 6 (provision of additional information) have been identified to be most effective to tackle the problems in the market and achieve the objectives of the initiative.

2.9. Assessment of the policy instruments

2.9.1. Self-regulation

As such, self-regulation could be a means of ensuring that consumers are provided with all the relevant information at the right moment.

One of the stated benefits of self-regulation is that it is flexible and may be easily modified to take into account market developments. The problems with the current content and format of the Code of Conduct as well as the moment at which the European Standardised Information Sheet is provided may be addressed by amending the existing Code of Conduct. Amendments to the Code could ensure that consumers receive all the relevant information to enable them to compare the offers available as well as assess the implications of the product and take a decision. In theory, if the Code signatories (mortgage lending industry and consumers) could reach an agreement to modify the Code, it could be immediately applicable to those organisations who have subscribed to it, quickly bringing the benefits of the modifications to consumers and creditors alike. This has the potential to improve consumer confidence and mobility. Recent research suggests that comprehensive ESIS provision, including via self-regulation, will boost consumer confidence in mortgage products, stimulate consumer mobility, encourage mortgage market development and stimulate cross-border lending.[496] In the event of a decision to continue self-regulation, the EU as a whole would however face net

[496] See footnote 136.

costs, albeit very small costs of EUR 8.8 million.[497] These costs would mainly be borne by those countries which already have a high compliance rate.[498]

However, as the Dialogue in 2006 between consumer and mortgage lending industry representatives illustrated, reaching an agreement could potentially be a long and difficult task, thereby largely neutralising the flexibility of self-regulation. Furthermore, the extent to which any agreement by the Dialogue meets the expectations of European consumers in providing all relevant information in a clear and comparable format would be dependent on the outcome of the negotiations, thereby possibly endangering the provision of optimal information. Furthermore, creditors who have already subscribed to the Code would face costs in implementing the modifications.

While amending the Code of Conduct to broaden the scope of information and to change its format would potentially solve the problem of incomplete information, it would be insufficient to completely solve the lack of comparability for several reasons. First, the Annual Percentage Rate of Charge would remain regulated by law at the national level and, given its different methodologies and cost bases, would remain difficult to compare across Europe. This cannot be addressed through self-regulation. Second, adherence to and implementation of the Code would have to be substantially improved. Credible and independent monitoring and enforcement mechanisms would need to be established. During the Mortgage Industry and Consumer Dialogue, the different parties were invited, without prejudging the future of the Code, to review possible monitoring and enforcement mechanisms to improve compliance. Consumer representatives argued that the Code was no alternative for binding rules but then in any case, redress should be available to consumers in case of failure to implement the information requirements and concrete penalties should be set. Industry representatives argued that creditor's own internal compliance mechanisms were sufficient.

In this respect, the current Code of Conduct on Home Loans neither appears to be flexible, thus neutralising one of its advantages, nor have any real efforts been made to improve its monitoring and enforcement. Consequently, neither changes to the content of the Code nor enhanced monitoring and enforcement mechanisms are foreseeable for the future. The persistent lack of comparability would mean that customer mobility remains impaired as the search costs associated with comparing information would remain high. Furthermore, self-regulation would not alter the current situation whereby creditors face additional national legal information requirements. Creditors operating cross-border would therefore continue to be subject to heterogeneous sets of information requirements and would continue to face the associated costs. Creditors complying with the Code would face the costs of implementing the changes to the Code whereas those who do not comply avoid such costs, creating an unlevel playing field.

2.9.2. Non-binding Community instrument

A Commission Recommendation to Member States on pre-contractual information is unlikely to be effective in improving the clarity, fairness, balance and comparability of mortgage credit advertising across Europe. This is because some Member States are likely to refrain from implementing the recommendation into national law while others may be prevented by the

497 See footnote 136.
498 See footnote 136.

existence of contravening national provisions and be reluctant to amend and/or abolish existing national provisions. It therefore follows that implementation is unlikely to reach at or near the 100 % level. This will result in a somewhat partial achievement of the objectives pursued under this initiative, with the extent of success largely dependent on how many Member States would decide to implement the Recommendation.

2.9.3. Binding Community instrument

A revised and legally binding European Standardised Information Sheet could be proposed, thereby ensuring that all EU consumers are provided with all the relevant information at the same and right moment. Proper consumer testing has been carried out to ensure that the standards meet with consumers' needs and expectations. However, the eventual extent to which any binding information requirements meet the needs of consumers would also be dependent on the outcome of the co-decision process.

Findings of the London Economics study suggest that comprehensive ESIS provision will boost consumer confidence in mortgage products, stimulate consumer mobility, encourage mortgage market development and stimulate cross-border lending.[499] An obligation to provide an European Standardised Information Sheet to all consumers seeking a mortgage will also facilitate customer mobility or switching of mortgage provider as mortgage product offers will be easier to compare. This is important as a recent survey found evidence suggesting that 31 % of mortgage holders who had not switched mortgage providers over the previous two years would consider doing so if comparable information was provided by all creditors.[500]

The estimated impact of a binding requirement to provide an ESIS on consumer confidence varies considerably among Member States. On the one hand, a very high impact can be expected for Member States with a very low ESIS provision such as, for example, Lithuania or Romania.[501] On the other hand, Member States in which the provision of ESIS is already very high, such as Austria or Belgium for example, the expected impact will be very low and for Germany and the United Kingdom, it is nil.[502] The provision of an ESIS to all consumers seeking a mortgage may also stimulate cross-border mortgage provision as such an obligation for ESIS provision would create a level playing field between domestic and foreign creditors.[503] A recent survey found evidence suggesting that those creditors that are already involved in cross-border activity through one or several channels expect, on average, that a requirement for ESIS provision could contribute to increase cross-border lending by 3 %, with one creditor judging that the effect could be as large as 6 to 10 %.[504] In conclusion, apart from the previously mentioned cases of Germany and the United Kingdom, a legal requirement to provide a revamped, more informative and simplified ESIS would have beneficial effects for consumers across the EU. Calculating and netting the costs and benefits of an obligation to provide a revamped ESIS in a timely manner, recent research has found net benefits of EUR 219 million for the EU27 as a whole.[505]

[499] See footnote 136.
[500] See footnote 346.
[501] See footnote 136.
[502] See footnote 136.
[503] See footnote 136.
[504] See footnote 136.
[505] See footnote 136.

Binding legislation could also improve the degree of comparability by ensuring that the information provided to consumers, including the Annual Percentage Rate of Charge, is comparable across the EU. By making pre-contractual information requirements and the Annual Percentage Rate of Charge binding, a level playing field would be established for consumers and industry alike, creating the right environment for enhanced competition. Whether the adoption of binding legislation would completely remove the obligation for creditors to comply with additional national legal requirements, would largely depend on the final wording of the text. The adoption of binding legislation would entail costs for several stakeholders. Creditors who have already adopted the Code would need to modify their European Standardised Information Sheet to take into account any changes. Creditors who do not yet comply with the Code would be required to do so thereby incurring the administrative costs of implementing the relevant measures. Assuming that any measure adopted would help reduce the multiplicity of information requirements across Europe, creditors operating cross-border would achieve administrative cost savings as the need to comply with heterogeneous information would be reduced. The net impact in terms of costs on creditors of the adoption of binding legislation is however difficult to clearly establish at this stage. Member States would face costs for implementing the EU legislation because they would have to adapt their national systems to the new legislation. The amount of those costs would depend largely on the compatibility of the EU legislation with existing national laws.

With an obligation to provide an updated ESIS in a timely manner, consumers will benefit from time savings, as the likelihood of obtaining an ESIS when contacting a creditor increases sharply. This benefit for consumers would, however, also entails costs for creditors and the overall impact is small and negative. Countries with high compliance rate in the provision of an ESIS would face higher net costs as the main effect would be consumers seeking to obtain an ESIS from more creditors in the post-policy intervention environment. In sharp contrast, in Member States with currently low compliance, consumers would also benefit from significant saving in searching for information as, in the post policy intervention period, ESIS would be provided comprehensively. To the extent that some consumers move to more suitable products as a result of universal ESIS provision may reduce creditors' losses in the future if the change in product selection has an impact on future defaults.

Introducing an obligation to provide the ESIS timely to consumer seeking a mortgage will have cost implications for governments and their respective regulators that need to implement, supervise and enforce the measure. The incremental costs of developing and passing new regulations would however be moderate.[506] Governments may also lose tax revenue as creditors and credit intermediaries may incur somewhat higher costs.

Creditors and credit intermediaries who did not provide ESISs pre-policy intervention will incur one-off costs to develop and implement new systems and processes and train their staff which will allow them to do so in the post-policy intervention. Moreover, those firms that do currently provide the ESIS only close to the provision of a binding offer are likely to have to provide many more ESIS forms than they do currently and will also incur higher operation costs. The number of additional ESISs that will have to be provided is equal to the total number of loans times the desired number of ESISs minus the number of ESISs that were provided before. Each ESIS is assumed to take only five minutes to prepare as the process is largely automated. It is likely that creditors will try to pass on part of the incremental costs to the consumers. Further incremental costs to firms will arise as there is a need to monitor

[506] See footnote 136.

compliance with a new rule internally. Moreover, firms will have to bear external compliance monitoring and enforcement as such costs are likely to be charged back through fees or special levies.

For credit intermediaries, the incremental costs will be slightly different than for creditors. As the ESIS is provided by the creditors, the incremental cost will be the time credit intermediaries will have to spend obtaining additional ESIS for their clients. In the longer run, it is possible that credit intermediaries will seek to obtain higher fees to offset the higher cost they incur.

In general, the Commission has the choice between a Directive and a Regulation as a binding policy instrument. A Directive has, on the one hand, the advantage of allowing for a more flexible approach, enabling both minimum and maximum harmonisation within the same instrument and thus is able to take into account the specificities of national markets. A minimum harmonisation Directive would allow more flexibility to Member States than a maximum harmonisation Directive, which would reduce the possibilities for Member States to gold plate. A Regulation, on the other hand, theoretically allows achieving the highest level of harmonisation and standardisation in a shorter timeframe without the need for national transposition measures. It also enables private enforcement by consumers and business alike, thus bringing the single market closer to the citizen.

While a Directive with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national specificities of the market. It is therefore recommended to use the legal instrument of a Directive.

2.10. Impact on Community resources and impacts on third countries

The preferred policy options on pre-contractual information do not have any impact on European Community resources.

Positive social impacts can be expected under this option. The option operates to substantially improve the clarity, fairness, and comparability of mortgage advertising, so that consumers are better informed, better aware, more able to compare, and less likely to be misled and suffer detriment. This reduces the likelihood that consumers end up with unsuitable and/or unsustainable products that can cause overindebtedness and defaults. It follows that the estimated reduction in defaults under this option confers an important social benefit to European consumers.

No impact on the environment can be expected from the policy proposals in the product suitability area.

With regard to the impact on third countries, the introduction of rules on pre-contractual information will not lead to discrimination against creditors or credit intermediaries from third countries willing to offer their services on the EU territory as they would need to comply with the same rules. If the proposed Directive is extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway. Finally, no direct impact on other countries is to be expected.

2.11. Conclusion

The introduction of measures to improve the quality and timing of pre-contractual information is expected to address effectively the problems identified and generate positive impacts on the European mortgage market. In conclusion, taking into account both the analysis by Commission services and the external cost-benefit analysis, a Directive containing an obligation to provided the ESIS to the consumer; specifying a deadline for the provision of the ESIS; improvements to the content and format of the ESIS; a standardisation of the APRC based on the CCD definition and a requirement to provide additional information on the actors have been identified to be most effective to tackle the problems in the market and achieve the objectives of the initiative. This would bring substantial benefits to consumers and society at large. While creditors and credit intermediaries are likely to face substantial costs, on balance, these are viewed to be outweighed by the benefits of provisions on pre-contractual information.

3. EXPLANATIONS AND ADVICE

3.1. Context

The provision of financial advice is one means to help come to terms with the range and complexity of products that they face. Financial advice is distinct from the provision of information. While information merely describes a product, advice means the provision of a personal recommendation to a consumer on suitable credit products for that consumer's needs and circumstances. Integral to the provision of advice is the provision of explanations on the risks and benefits of particular products. Explanations can nonetheless also be provided to a customer in a non-advised sale and, in that context, any implicit or explicit recommendation to opt for any particular products would be strictly avoided. A non-advised sale would, in fact, constitute an advised sale if the explanations provided by the seller would be understood as a recommendation for the customer to opt for a specific product, and the seller does not expressly alert the customer that he is not in a position to provide any advice or recommendation. Mortgage credit advice is often provided by lenders as well as credit intermediaries who are independent or tied to one or more lenders.

The provision of mortgage advice which is objective, based on the profile of the borrower, and commensurate with the complexity of the products and the risks involved, is crucial in order for borrowers to end up with the product most suitable to their needs. Appropriate financial advice becomes all the more important for borrowers given the ever growing complexity of mortgage credit products, the large number of different products and product providers, and the fact that many potential borrowers do not possess an adequate level of financial literacy. The information given by banks to customers on the way their mortgages work and the risks involved is considered by 59 % of European consumers as difficult to understand[507]. All these elements aggravate the information asymmetries in this market and can be conducive to market failure. The issue of financial literacy, which relates to financial education and awareness, is being examined in separate initiatives by the Commission[508] and is therefore outside the scope of this exercise.

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507 See footnote 81. See also Special Eurobarometer 298, June 2008.

508 The Commission has set up an expert group on financial education and has established a European Database on Financial Education (EDFE) as a new information tool on the wide range of the schemes

The current financial turmoil, and in particular the rising level of credit defaults, foreclosures and repossessions observed[509], illustrates the sort of consequences that can follow from consumers purchasing credit products that are unsuitable for them. Although there are always unexpected life events that can lead people to default, data suggests that in many cases consumers may have obtained loans that were not appropriate for them[510]. Against this background, the provision of high quality financial advice to potential borrowers, which can serve to improve the compatibility between specific products and specific borrowers, acquires particular importance.

According to a 2005 Eurobarometer survey, although 92 % of European consumers assert their autonomy when making financial decisions, 72 % of consumers expect financial institutions to give them advice (this figure however masks large differences within the EU ranging from 38 % in Latvia and Hungary to 95 % in Slovenia)[511]. Other research in individual Member States confirms that consumers do in fact frequently seek advice when taking out a mortgage credit.[512] For example, in the United Kingdom, approximately 68 % of people survey sought financial advice for purchasing a mortgage.[513] This corresponds with the fact that 70 % of all mortgage transactions between April 2007 and March 2008 and 91 % of all the mortgages sold via credit intermediaries were advised sales[514]. In Germany, strong growth has been observed in the demand for competent as well as comprehensive financial advice[515], with approximately 76 % of consumers in 2006 seeking financial advice for purchasing a mortgage.[516] Moreover, the percentage of consumers seeking financial advice for purchasing a mortgage product in France, Spain and Sweden was approximately 72 %, 60 %, 75 %, respectively.[517] It is further worth mentioning that a consumer survey in 2006 showed that customers considered 'excellent advice' as the most important value driver in France, Germany, Spain and Sweden, while the United Kingdom prioritised 'best price'[518].

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available across the EU. See for more information http://ec.europa.eu/internal_market/finservices-retail/capability/index_en.htm.

509 For the US see foreclosure database at http://www.realtytrac.com/home.asp?a=b . For the United Kingdom see *Global Financial Stability Report*, IMF, October 2008, at http://www.imf.org/external/pubs/ft/gfsr/2008/02/pdf/text.pdf and the UK Council of Mortgage Lenders statistics on arrears and possessions at http://www.cml.org.uk/cml/media/press/2108. For Spain see http://news.kyero.com/2009/4/17/spanish-foreclosures-doubled-in-2008. For defaults/foreclosures data in more EU countries, see European Mortgage Federation Factsheets, at http://www.hypo.org/content/Default.asp?PageID=344.

510 At the peak of the market in 2007, 45 % of UK mortgages were without income checks, a large part of which was self-certified. See http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0706_lt.shtml. More in general, banks accept that they are partially responsible for the financial turmoil. See, i.e. *EBF Newsletter 19*, 2009.

511 See footnote 81.

512 *European Mortgage Distribution: changing channel choices*, Fortis, EFMA and Oliver Wyman, 2007. The percentage of consumers seeking financial advice for purchasing a mortgage product in Germany, Spain, France, Sweden and the United Kingdom was approximately 76 %, 60 %, 72 %, 75 %, 68 % respectively. This is based on an online survey of 2 500 individuals in 2006.

513 *European Mortgage Distribution: changing channel choices*, Fortis, EFMA and Oliver Wyman, 2007. Based on an online survey of 2 500 individuals in 2006.

514 *Mortgage Product Sales Data trends Report*, UK Financial Services Authority, September 2008. For further information see http://www.fsa.gov.uk/pubs/other/psd_trends_mortgage.pdf.

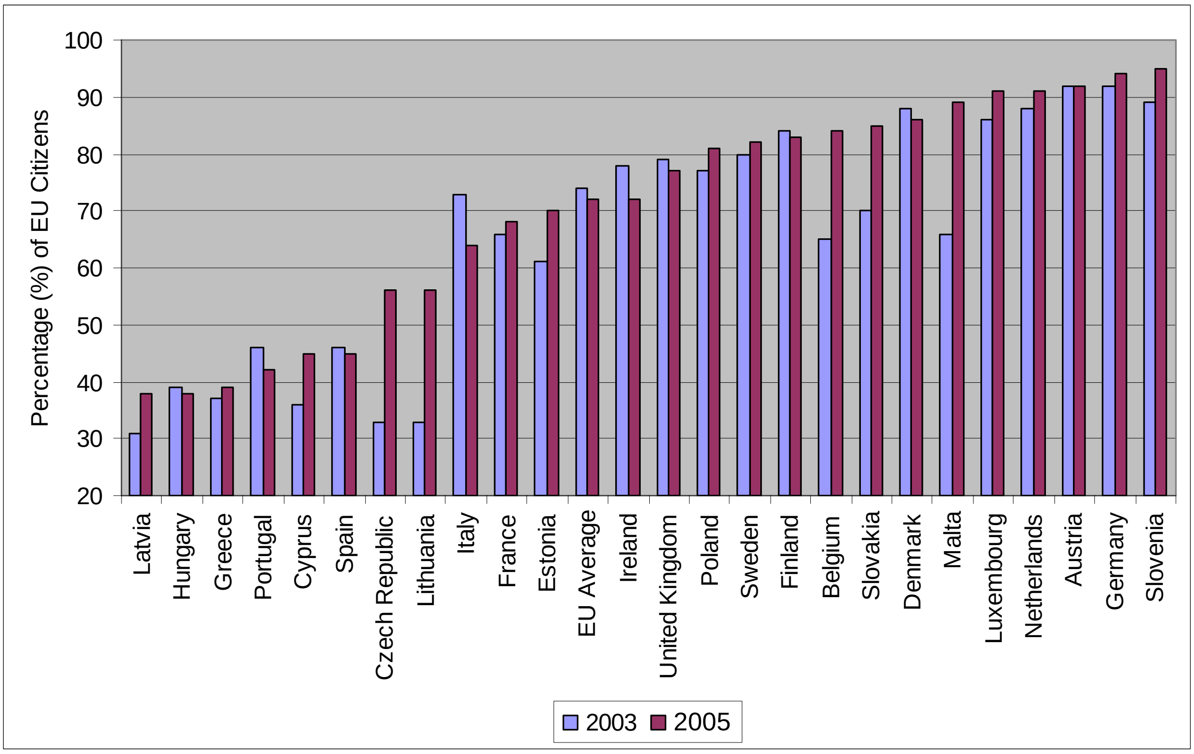
515 *Financial Advice Giving and Taking*, A.Oehler, D.Kohlert, Journal of Consumer Policy, June 2009, http://www.springerlink.com/content/l146v541837l1819/.

516 See footnote 513.

517 See footnote 513.

518 See footnote 513.

Graph 6: Percentage of EU citizens who expect financial institutions to give advice



Source: *Public Opinion in Europe: Financial Services*, Special Eurobarometer 230, August 2005, p. 79

At the same time, on the one hand, less than half (46 %) of the consumers surveyed in the Eurobarometer survey actually trust the advice provided by the financial institution, with the figure as low as 17 % in Greece[519]. Another survey demonstrated that consumers exhibit considerable distrust towards financial service providers, based inter alia on opaque language which makes them believe that they intend to hide unfavourable conditions[520]. This circumspectness of consumers is not unfounded; data reveals that there is indeed a problem in the provision of appropriate advice[521]. On the other hand, many consumers tend to rely, without much reflection, on the advice of a familiar bank employee in their local branch because they perceive him to be trustworthy and an expert in his profession[522].

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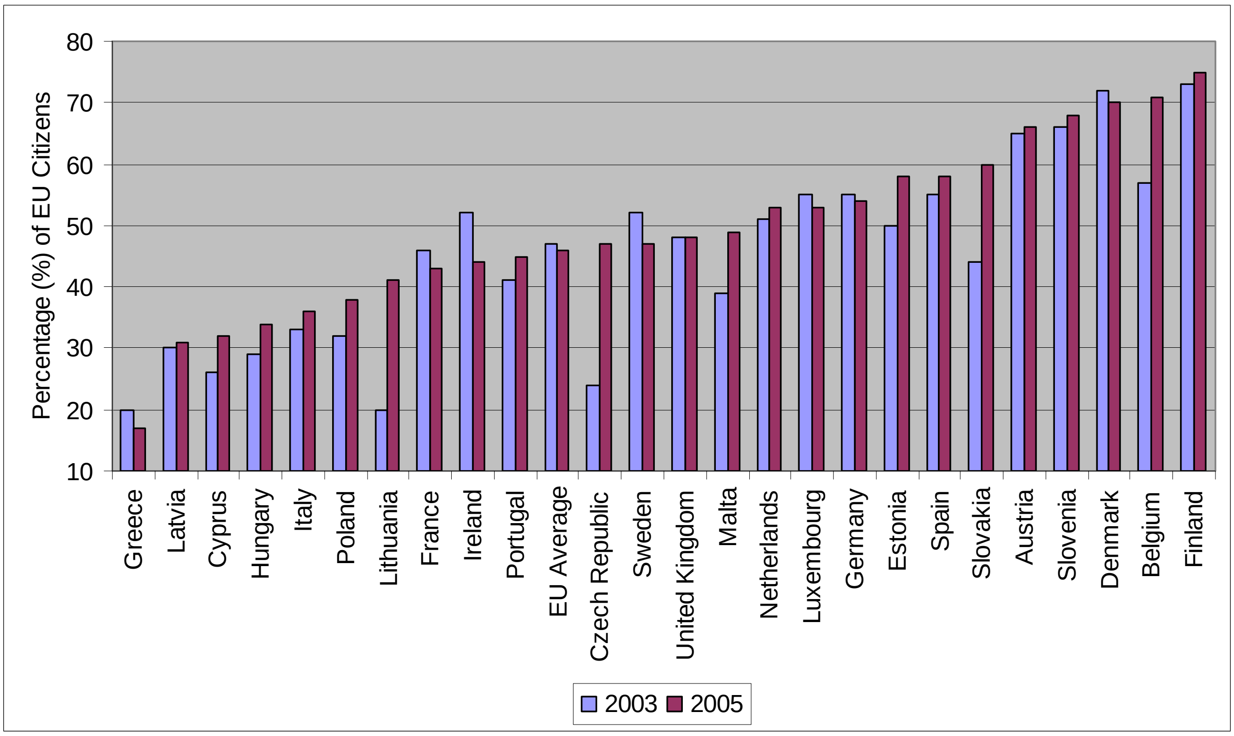
519 See footnote 81.

520 *Report on pre-contractual information for financial services*, Optem, January 2008.

521 Out of a sample of 252 firms, the FSA found that only a third had robust process in place to enable them to give customers suitable advice, http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/001.shtml. In Germany, a mystery shopping exercise found 24 out of 25 bank advisors providing unsuitable advice, http://www.vzbv.de/go/presse/1172/3/9/index.html.

522 *Expert Financial Advice Neurobiologically "Offloads" Financial Decision-Making Under Risk*, Engelmann J.B., Capra C.M, Noussair C., Berns G.S., 2009.

Graph 7: Percentage of EU citizens who trust advice from financial institutions



Source: *Public Opinion in Europe: Financial Services*, Special Eurobarometer 230, August 2005, p. 79

The large number of European consumers that expect financial institutions to give them advice (despite the fact that they often do not trust the advice)[523], as well as the frequency by which consumers seek advice on mortgage or consumer credit[524], point to the fact that many consumers probably do so because they experience increasing difficulty in understanding credit products as well as the consequences of their product choice. The complexity of mortgage credit products and the resulting difficulty for consumers to understand their implications drive a demand from consumers for financial advice that should allow them to better understand and feel more confident of the consequences of their product choice.

This lack of trust is problematic because, as it is demonstrated in the problem section further below, it negatively impacts consumer confidence, customer mobility, and cross-border activity. However, it is equally problematic when some consumers exhibit a high degree of trust that may be premised on false assumptions, such as that there is no reason for the adviser not to act in the best interest of the client, when in fact the adviser has incentives not to act in the client's best interest.

The fact, however, that there is a low level of trust towards the explanations and advice that consumers receive[525], leads to a low level of consumer confidence. The seriousness of this problem is exacerbated by the often negative perceptions of consumers that result from data

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523 See footnote 81.

524 See footnote 514. On consumer credit, the UK's Citizens Advice Bureau reported that inquiries for advice on debt hit a record high, increasing by 20 % bringing the total to 1.7 million, and that credit card debt and problems with unsecured loans dominated, accounting for 40 % of the CAB debt caseload. See *Press release*, September 2007, http://www.nacab.org.uk/index/pressoffice/press_index/press_20070910.htm.

525 See footnote 81.

on cases of inappropriate advice[526], as well as the role of financial institutions in the context of the current financial turmoil[527]. When consumers are suspicious and circumspect of the quality of services provided by financial institutions, and particularly the explanations and advice they provide, their level of confidence remains low. This has knock-on consequences for cross-border customer mobility because consumers that have little trust in the advice provided in their home Member States and are not confident enough, would probably be even more reluctant to engage in cross-border shopping for credit.

3.2. Overview of the legislative framework

An analysis of the current situation concerning the provision of financial advice on mortgage credit products involves focusing on the existing situation at Community and at national level.

3.2.1. EU level

Community rules and standards on the provision of advice currently exist for certain types of financial products, but not for others[528]. Of particular importance is the absence of any Community rules or standards on the provision of advice on mortgage credit. Although the Commission clearly positioned itself in its 2007 White Paper on the Integration of EU Mortgage Credit Markets against the introduction of a legal obligation to provide credit advice, it also stated that it wishes to promote high-level advice standards, whilst recognising that not all consumers need the same level of advice[529]. High-level advice standards should contribute to a more optimal matching between specific credit products and specific borrowers. The fact that the current financial turmoil was at least partially due to many consumers having obtained credit products that were not appropriate for them[530], supports the validity of the Commission's desired action on the provision of credit advice.

On consumer credit, although the CCD[531] does not explicitly regulate advice, however it calls for adequate explanations to be given to the borrower (a 'duty to explain'), so that the borrower can assess whether the proposed credit is adapted to his needs. It is noted however that the Directive does not apply to mortgage credit or credit agreements beyond EUR 75 000.

Furthermore, some advice standards exist in other Community legislation on financial services: Under Article 19(1) of the Markets in Financial Instruments Directive (MiFID)[532] when providing investment advice, the provider (bank or investment firm) must assess the client's knowledge and experience relevant to the services he wishes to engage in, his financial situation and his objectives before making a decision on recommending a product that is suitable for him. If the client wishes to buy a product that the distributor deems not to

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526 See footnote 521.

527 According to the UK FSA, there were "mistakes by financial institutions... ...and confidence was undermined by lending to uncreditworthy customers, with a built-up of risky practices – subprime lending, self-certified mortgages... …consumers and intermediaries taking their share of responsibility". See http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0706_lt.shtml.

528 For a detailed description, see paragraphs below.

529 COM(2007) 807, SEC(2007) 1684 and SEC(2007) 1683.

530 This was especially the case with US subprime and Alt-A loans. An FSA review in the United Kingdom found that in a third of the files examined, intermediaries and lenders made an inadequate affordability assessment. See http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/081.shtml.

531 See footnote 254, Article 5(6).

532 Directive 2004/39/EC.

be appropriate, the client must be warned[533]. Similarly in the Insurance Mediation Directive[534], Article 12(3) stipulates that the intermediary shall specify the demands and needs of the customer, and give underlying reasons for any advice given to the customer on any given product.

3.2.2. Member State level

At Member State level, different legal traditions have led to a substantial degree of differentiation in the provision of credit advice. A number of Member States do have specific rules or standards on the provision of advice, a main function of which is to prevent conflicts of interest and better align the interests of clients and advisors. These rules however differ to different extents from one country to another in terms of content. In terms of form, they also differ and may be legislative, judicial, or self-regulatory. Added to this is a group of countries that do not have any particular provisions on credit advice. The information in Table 14 illustrates what is, to our knowledge, the situation concerning rules and standards on mortgage credit advice in the 27 Member States[535] (it is very likely that in many cases these rules apply to all credit advice and not only mortgage credit).

Table 14: Overview of rules on the provision of mortgage advice

Country	Legal, judicial or self-regulatory rules on the provision of mortgage credit advice
Austria	Limited/No Provisions. It was found that legislation imposes a duty of care which requires creditors (not credit intermediaries) to provide explanations to consumers in order to enable them to assess whether a proposed credit agreement is suitable for them.
Belgium	Limited/No Provisions. It was found that an obligation to provide advice to the client may arise in certain situations, according to Belgian case law.
Bulgaria	Limited/No Provisions. According to the Ethical Code of the Association of Bulgarian banks, banks should provide information on risks and information on the banks' products/services and on advising the clients regarding the specifications of the contracts offered. However, there are no requirements on credit intermediaries relating to the provision of explanations or advice.
Cyprus	Limited/No Provisions. Industry self-regulation states that when banks provide advice, they should act honestly, fairly, and professionally, in accordance with the best interest of the client. There are no similar requirements for credit intermediaries.
Czech Republic	Limited/No Provisions. There is a legal requirement for creditors and credit intermediaries to provide explanations to consumers in order to enable the consumer to assess whether the proposed credit agreement is suitable for them. Also, a legal requirement for banks to act honestly, fairly, and professionally, in accordance with the best interests of the client, and refrain from lending to a client if doing so would be too risky.
Denmark	Legal duty to provide advice if the customer so requests or if circumstances indicate there is reason to do so. Alternatively, the institution may refer the customer to seek advice elsewhere.[536] Also, a legal requirement on creditors and credit intermediaries to provide explanations to consumers.
Estonia	Limited/No provisions. There is a requirement under the EFSA guidelines for creditors to provide explanations to consumers in order to enable them to assess whether the proposed credit agreement is suitable for them. Also, a legal requirement for creditors to act honestly, fairly, and professionally, in accordance with the best interests of the client, and refrain from lending to a client if doing so would be too risky.
Finland	Limited/No provisions. There is a requirement under the FFSA's Code of Conduct for the Provision of Financial Services (Standard 2.1) that creditors provide explanations to consumers in order to enable them to assess whether a proposed credit agreement is suitable for them. Also, a legal requirement for creditors to act honestly, fairly, and professionally, in accordance with the best interests of the client.

533 Directive 2004/39/EC, Articles 19(4) & (5).

534 2002/92/EC

535 Data obtained from the responses of Member States to the Questionnaire addressed to the Government Expert Group on Mortgage Credit (GEGMC) of 3.4.2008; also from the *Study on Costs and Benefits of Policy Options for Mortgage Credit* (Legal Baseline Assessment).

536 See, *Executive order on Good Practice for Financial Undertakings*, Executive Order no. 1046 of 27.10.2004, Part 3.

France	Limited/No provisions. Case law distinguishes between the obligation to alert on risks, and the counselling duty where the banker 'orientates' the decision of the borrower by advising and recommending the most suitable product. In the case of mortgage loans, there is a case law duty to warn the 'uninformed' client, but no duty to advise unless the sale relates to an insurance product. No requirement exists for the provision of explanations, although the duty to warn may effectively amount also to a duty to provide explanations.
Germany	Limited. According to an interpretation of German Civil law (Article 241) by Prof. Reifner, a general obligation exists for exhausting and correct advice in cases where: a sophisticated product is sold, the producer has himself raised expectations which are not valid, or the consumer has asked for advice himself. Also, it seems that a case law duty to give a warning and/or provide advice applies in certain cases, such as a disproportionate relation between price and value of property.
Greece	Limited/No provisions. Creditors are required under an industry self-regulatory provision (the Code of Banking Ethic) to act honestly, fairly and professionally in accordance with the best interests of the client. There is a requirement under the Governor's Act 2501/2002 that creditors and credit intermediaries provide explanations to consumers in order to enable them to assess whether the proposed credit agreement is suitable for them.
Hungary	Limited/No provisions. Creditors are legally required to act honestly, fairly, and professionally, in accordance with the best interests of the client, provide 'risk warnings' in special situations. Also, according to the Ministry of Finance, there is a legal requirement that creditors and credit intermediaries provide explanations to consumers in order to enable them to assess whether the proposed credit agreement is suitable for them.
Ireland	No duty to advise, but when advice is provided it must be done according to legal rules applying both to creditors and credit intermediaries: honesty, fairness, in the best interest of the client, documentation of the grounds for the advice, ensure the product recommended is suitable for the specific client, etc[537]. Legal duty for both creditors and credit intermediaries to provide explanations.
Italy	Limited/No provisions. No requirement to provide explanations exists, but ethical standards require creditors to act honestly, fairly, and professionally, in accordance with the best interests of the client.
Latvia	Limited/No provisions. Creditors are required under legal/regulatory obligations to act honestly, fairly and professionally, in accordance with the best interests of the client. Under Article 4 of the Consumer Rights Protection Law, there is a requirement for creditors and credit intermediaries to provide explanations to consumers.
Lithuania	Limited/No provisions. There are no requirements for creditors/credit intermediaries to provide explanations, or to act honestly, fairly and professionally, in accordance with the best interests of the client, or to give risk warnings.
Luxembourg	Limited/No provisions. No specific rules, apart from the general civil responsibility regime and bank self-regulatory principles on loyalty, integrity, competence, care and diligence, security and reliability, etc. Under the self-regulation rules, banks should provide clients with explanations.
Malta	Limited. Self-regulation stating that banks' credit policies should ensure that the best advice is given to customers.
Netherlands	There is no duty to provide advice but the legislation provides that the financial undertaking gives advice unless specifically stated that advice is not being provided. If advice is provided, the advisor should investigate the financial position, knowledge, experience and willingness to take risks.[538] Legal duty for creditors and credit intermediaries to provide explanations. In practice it is very difficult to sell mortgages without advice.
Poland	Limited/No provisions. But Recommendation SII (non-binding, PFSA) states that banks (not credit intermediaries) should provide explanations to consumers in order to enable them to assess whether the proposed credit agreement is suitable for them. Creditors are also legally required to act honestly, fairly and professionally, in accordance with the best interests of the client, and to give risk warnings.
Portugal	Limited/No provisions. Creditors are legally obliged to provide explanations to the client, but not credit intermediaries. Law also requires creditors to act honestly, fairly and professionally, in accordance with the best interests of the client, and to give risk warnings.
Romania	Limited/No Provisions. Only a legislative requirement for creditors to provide 'risk warnings' on the consequences attached with default.
Slovakia	Limited/No provisions. Banks have a Code of Ethics on Consumer Protection by which they undertake to provide explanations to consumers, as well as to act honestly, fairly and professionally in accordance with the best interests of the client.
Slovenia	Limited/No Provisions. There is a requirement under Article 6 of the Consumer Credit Act that creditors and credit intermediaries provide explanations to consumers in order to enable them to assess whether the proposed credit agreement is suitable for them.
Spain	Limited/No Provisions. There is a legal requirement for creditors and credit intermediaries to provide adequate explanations. Credit intermediaries are legally obliged to give clear and precise information to clients.

537 Irish Consumer Protection Code, 1.8.2006, at http://www.financialregulator.ie/processes/consumer-protection-code/Documents/Consumer%20Protection%20Code.pdf.

538 Dutch Financial Services Act, 12.5.2005, Section 32. Also, the Act of Financial Supervision, Article 4:23.

Sweden	Limited/No Provisions. Recommendations of the Swedish FSA and the Consumers Agency require creditors and credit intermediaries to provide adequate explanations to the consumer in order to enable the consumer to assess whether the proposed credit agreement is adapted to her/his needs and financial situation. Also there is legislation requiring creditors to act honestly, fairly and professionally in accordance with the best interests of the client.
United Kingdom	No duty to provide advice, but if advice is provided, it must comply with regulatory standards: the individual adviser should be competent, the affordability must be considered, the consumer's needs and circumstances must be identified, and the firm must identify the most suitable mortgage for the individual consumer.[539]

Source: London Economics, 2009

It may be argued that the successful implementation of the CCD will bring about a degree of standardisation to the situation presented in the table above. This could result from the operation of Article 5(6) of the Directive, which based on information provided by Member States to the Commission, 15 Member States (Austria, Belgium, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, Malta, the Netherlands, Romania, Slovakia, Slovenia and Sweden) intend also apply to mortgage credit. UK mortgage rules require a firm to provide disclosures and explain the importance of reading it. Currently there is no requirement to talk through the key product risks and features. In France, adequate explanations are partially covered by the warning duty defined by case law. Spain also has a similar provision in specific mortgage credit and financial intermediaries' legislation.

3.3. Problem description

3.3.1. Risk that conflicts of interest (e.g. remuneration) influence the quality of advice

Consumers' limited information and knowledge about the product and intermediary itself creates a potential incentive for the broker to exploit this information asymmetry. If incentive schemes of credit intermediaries or their agents are misaligned with the needs of consumers, and if credit intermediaries effectively take advantage of the existing information asymmetry regarding the consumer as described above, there is a clear risk that unsuitable products are sold, to the detriment of the consumer. Some advisors might fail to provide independent advice because of disincentives to do so, e.g. because they receive different levels of remuneration from different product providers for the sale of different products, as well as because their remuneration is most often based on the volume of credit granted[540]. An example where this sort of situation can be demonstrated involved a credit intermediary in the United Kingdom. The intermediary arranged mortgage credit for his clients, and after two years he advised them to re-mortgage, despite the fact that this would be financially disadvantageous for the clients[541]. Such remuneration structures give advisors an incentive to recommend certain products, not necessarily because it is in the interest of the consumer but because it is in the advisor's own financial interest. Furthermore, an asymmetry of interests exists in cases where the advisor's remuneration is conditional on a contract being signed and not on the borrower respecting his contractual duties on the repayment of the loan[542], as this can lead to the advisor recommending a credit which the borrower cannot afford to repay.

In addition, if an advisor fails to take fully into account the personal circumstances of the borrower, because the time to assess those circumstances represents a cost for the former,

539 *Mortgage and Home Finance: Conduct of Business Sourcebook*, UK Financial Services Authority, MCOB 4.7 Advised sales, http://fsahandbook.info/FSA/html/handbook/MCOB/4/7.

540 See footnote 6.

541 See footnote 6.

542 See footnote 6.

there is a risk that an unsuitable product is recommended, leading – in the worst case scenario – to the default of the consumer. This would have knock-on consequences for both the lender or, if the loans were sold or securitised on capital markets, investors, who would face a greater risk of default of the loan and would have to manage the consequences. Moreover, an advisor may fail to disclose to the customer that he only provides advice on products originating from only one or a small number of lenders, out of concern that the customer may prefer to seek a whole-of-market advisor. In fact, a survey in the United Kingdom has demonstrated that 43 % of consumers did not recognise that high street lenders only provide information on their own products[543].

The seeking by consumers of financial advice is a common response to their insufficient understanding of credit products and their consequences[544]. It has been demonstrated however that a large number of consumers have little trust in the advice they receive[545]. It may be the case that for some consumers the reason for this lack of trust relates to the fact that a number of cases have come to light where advisors were found to have provided inappropriate advice[546] or to lack the means necessary for providing appropriate advice[547]. Data provided by the Financial Ombudsmen in the United Kingdom, Ireland and Denmark has revealed a growth in the number of complaints concerning mortgage advice between 2007 and 2008[548]. Likewise, in Ireland, endowment mortgages[549] were strongly marketed in the late 1980s and early 1990s, partly due to their lucrative commission structures. Many Irish consumers are now facing shortfalls and class action is being considered on the basis of mis-selling allegations.[550] A particularly important source of mistrust is likely to be the evident asymmetry that consumers can logically perceive between their interests and the interests of the provider of advice.

Given the role that financial advice plays in addressing consumers' difficulties in understanding credit products and their consequences, the risk that the advice provided is influenced by conflicts of interest can cause very serious problems: it reduces consumer trust and confidence; and it creates a real risk that consumers are led to purchase unsuitable products which, in the worst case scenario, lead to rising levels of debt, defaults and foreclosures. This also has a negative impact on customer mobility, in particular in a cross-border context, because consumers that have little trust in the advice provided in their home Member States would probably be even more reluctant to engage in cross-border shopping for credit.

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543 *The Value of Mortgage Advice*, Association of Mortgage Intermediaries, 2008.

544 See footnote 514 and *Financial Advice Giving and Taking*, A. Oehler, D. Kohlert, Journal of Consumer Policy, June 2009, http://www.springerlink.com/content/l146v541837l1819/.

545 See footnote 81.

546 See footnote 6.

547 See footnote 521.

548 Questionnaire to the attention of the FIN-NET Members, July 2009. France, Iceland, and Portugal reported zero complaints relating to mortgage products, while Belgium, Germany, Greece and Spain had no data available.

549 "A mortgage linked to an endowment insurance policy which is intended to repay the capital sum on maturity", http://oxforddictionaries.com/view/entry/m_en_gb0265610#m_en_gb0265610.

550 *When your endowment mortgage falls short*, The Irish Times, 7.6.2010.

3.3.2. *Lack of clarity on liability for unsuitable advice*

Mainstream legal discourse states that the more clear and unambiguous rules are, the greater the degree of legal certainty in the system[551]. It logically follows from this that the existence of rules or standards on the provision of credit advice, and clear and unambiguous rules in particular, contribute to a high degree of legal certainty. By implication, in those Member States where standards for the provision of advice on mortgage credit products exist, substantial legal certainty exists concerning liability/redress for unsuitable advice.

In the United Kingdom for example, a Member State which has advice standards in place, a number of cases of unsuitable advice were referred to the Financial Services Authority or to the Financial Ombudsman. The facts of these cases were also examined against the professional standards that must be followed when providing advice. Many advice providers were held liable for providing inappropriate advice and received fines or paid damages[552]. In one specific case, the UK Financial Ombudsman upheld a claimant's complaint and ordered the advisor to pay damages for having failed to adequately assess the former's financial situation prior to making a recommendation for mortgage credit that caused the claimant to suffer a loss. In this case, the advisor's conduct had clearly fallen short of what is required under the United Kingdom's rules on the provision of advice[553]. Similarly in Ireland, the Irish Financial Ombudsman ordered an advisor to pay a large compensation to a client who suffered a large loss due to inappropriate advice given to her. In this case also, the advisor's conduct fell short of what is required by the Irish standards relating to the provision of advice[554].

When no standards exist against which the provision of advice can be assessed, it becomes difficult to determine whether the advice given was unsuitable. While this does not mean that an individual is excluded from access to legal or other type of adjudication, the judicial organs could be reluctant to impose liability on an operator in the absence of rules with which his conduct must comply. There is of course always the possibility to assess liability in terms of duty of care, but finding a defendant liable for cases other than fraud would still be difficult in the absence of advice standards.

It follows from the above that the existence of standards according to which advice is given, improves clarity on legal liability for inappropriate advice. It allows consumers to know what rules govern the advisors conduct, and they can legally challenge this conduct if they think it is not consistent with the rules. Cases referred to courts will lead to the creation of precedence that will provide more explicit explanations on the meaning and effect of the standards, providing thus even more clarity and certainty. Such clarity and certainty benefits not only consumers, but also providers of advice, as it enables them to know what sort of conduct is appropriate and safe, and what is not appropriate and can give rise to legal liability.

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551 See, i.e. *Legal Certainty Vs. Equity in the Conflict of Laws*, Law and Contemporary Problems, Vol. 28, No. 4, P.H.Neuhaus. The author states that "legal certainty refers to the public interest in clear, equal, and foreseeable rules of law which enable those who are subject to them to order their behaviour in such a manner as to avoid conflict or to make clear predictions of their chances in litigation".

552 See footnote 6.

553 See footnote 539.

554 See footnote 537.

As it had been stated however[555], most Member States do not have rules on the provision of advice. The absence of rules leads to a lesser degree of clarity concerning legal liability for inappropriate advice for the various reasons outlined above. This is in the consumers' detriment because in the absence of rules against which the advisor's conduct can be assessed, it is difficult for the complainant to determine whether he has a prima facie case which he can pursue. It is also in the advisors' detriment because, although he is not required to abide by any advice standards, he is still faced with the possibility that a court can find him liable on a duty of care count which he had not foreseen. The difference in legal certainty exists not only between the group of Member States that have rules on advice and the group of Member States that do not have such rules. Given that in the group of countries that have rules, these rules differ to different extents from one country to the other, there can also be variations among them in terms of clarity and certainty for legal liability for inappropriate advice.

While it follows that the greater lack of clarity on liability for unsuitable advice exists in those Member States that have no rules on the provision of advice, a more general concern relates to the fact that there are significant distortions on the degree of legal certainty and clarity on this issue across Europe. Faced with these distortions, consumers are likely to be less confident, and less willing to shop cross-border for credit. This means that the level of consumer confidence and customer mobility in this domain will remain low. Furthermore, the current situation is also prejudicial to cross-border activity by creditors and credit intermediaries providing advice. The different degrees of clarity and legal certainty for liability for inappropriate advice in the different Member States very likely acts as a significant burden and dissuading factor that keeps cross-border activity at low levels.

3.3.3. Absence of regulatory standards to ensure a high quality of advice

The absence of EU regulatory standards or guidance on the provision of high quality mortgage advice across the EU constitutes a regulatory failure. Consumers cannot be sure that the advice they receive is of high quality and can be relied upon, neither are they afforded the same level of protection across Europe. This impacts consumer confidence as well as customer mobility. In particular, this situation is likely to restrict cross-border shopping by consumers who can be intimidated by different rules, level of protection, and risks. This would come to be added to the general 'domestic bias' of consumers in respect to financial products.

Creditors and credit intermediaries providing advice are faced with additional burdens when trying to operate cross-border due to divergent rules and practices. In many cases, advice providers who offer their services in more than one Member State will need to apply different work practices or create new standard operating procedures according to the approach of each Member State towards the provision of advice. This hinders cross-border business and the realisation of a single market.

[555] See Table 13 on individual Member States situation.

3.3.4. Summary of problems and consequences

Table 15: Problems and consequences

Specific problems and their drivers	Consequences
Provision of inappropriate advice • Conflicts of interest, arising for example from remuneration systems, can influence the quality of advice • Lack of clarity on liability for unsuitable advice • Absence of regulatory standards to ensure a high quality of advice	**Risk of consumer detriment & reduced customer mobility** – large information asymmetries, consumer mistrust and circumspectness – uncertainty concerning possibility to challenge inappropriate advice – consumers purchase a credit product which is unsuitable for them => risk of overindebtedness, default, and foreclosure on home => reduced consumer confidence => reduced customer mobility **Low cross-border activity & missed business opportunities** – dual or multiple regulatory burdens for creditors and credit intermediaries caused by different national rules on providing of mortgage advice – uncertainty concerning liability for inappropriate advice => reduced cross-border business => malfunctioning of competition in the single market

3.4. Stakeholder views

This section is based on the views expressed by stakeholders during the consultation on responsible lending and borrowing.[556]

3.4.1. Consumers

Consumer advocates support the introduction of credit advice standards as a good minimum level of service. Many underlined that such standards would only be valuable if appropriately enforced by statutory authorities, and sanctions applied in cases of breach. The adherence to such advice standards could form part of the ongoing requirements in order to be licensed to provide credit advice. However, it is feared that advice standards would be ignored unless they formed part of an approach that would make responsible lending profitable for the creditor.

3.4.2. Financial services industry

Many respondents from financial services industry federations and providers argued strongly against the introduction of an obligation to advise. Several federations noted that the introduction of advice standards could imply to borrowers that advice is required to be given. There were also claims that the introduction of advice standards could create legal uncertainty, and open creditors up to the threat of more non-enforceable contracts. UK-based organisations also pointed to the different requirements applicable there to advised and non-advised sales. Reference was made to the fact that advice as set out in the Markets in Financial Instruments Directive (MiFID) is a specific financial service, but that it was not possible to directly read across requirements from the investment to the credit market. National federations representing financial intermediaries were generally more supportive of the introduction of the suggested advice standards, with some putting forward additional standards, namely concerning the disclosure of particular risks and the identity of the

556 Consultation feedback available at: http://ec.europa.eu/internal_market/finservices-retail/credit/responsible_lending_en.htm.

intermediary. Credit unions, microfinance providers and financial sector trade unions were also generally in favour of such advice standards.

3.4.3. Member States

Member State authorities' attitudes to the proposed advice standards were mixed as in some Member States similar standards are already included in statutory requirements while others mentioned that they would welcome such standards to be included in EU-legislation. A Majority of the Members State authorities indicated that harmonisation of advice standards at EU level would be difficult to achieve. The suggested standards could perhaps be better presented as best practices, and be adopted in Member States on a voluntary basis or, incorporated into codes of ethics adopted by the financial services sector. Reference was made to the debates that preceded the adoption of the CCD, and the agreement that had been finally reached to require 'adequate explanations' rather than advice, and suggested that this was sufficient. A few also mentioned that employees of creditors and tied intermediaries could not be expected to adhere to advice standards, as they would necessarily only be recommending the products of their employer. One Member State authority questioned how adherence to advice standards could be objectively assessed and given legal certainty.

3.5. Objectives

3.5.1. General objectives

- To create an efficient and competitive Single Market with a high level of consumer protection by fostering:
    - consumer confidence;
    - customer mobility;
    - cross-border activity of creditors and credit intermediaries;
    - a level playing field.
- Promote financial stability throughout the EU by ensuring that mortgage credit markets operate in a responsible manner.

3.5.2. Specific objectives

- Ensure that any mortgage credit advice provided to a consumer is objective, impartial, and in the consumers' best interest.

3.5.3. Operational objectives

- Minimise the risk that conflicts of interest (e.g. remuneration) influences the quality of advice.
- Improve the degree of legal certainty in respect to the provision of advice.
- Ensure that providers of advice meet minimum standards.

– Ensure that customers shopping cross-border and operators wishing to offer their services cross-border are not being burdened by incomparable advising rules.

3.6. Description of policy options

3.6.1. Mortgage advice

3.6.1.1. Option 1.1: Do nothing

Doing nothing on this issue means that all the problems identified will remain. 15 Member States[557] will however extend the application Article 5(6) of the CCD on the duty to explain to mortgage credit.

3.6.1.2. Option 1.2: Requirement to provide adequate explanations

The Commission could introduce of a requirement on creditors and, where applicable, credit intermediaries, to provide adequate explanations to consumers in respect to mortgage credit products. This 'duty to explain' could be formulated in the same way as the explanations requirement in Article 5(6) of the CCD. In particular, Article 5(6) provides that: "…creditors and, where applicable, credit intermediaries provide adequate explanations to the consumer, in order to place the consumer in a position enabling him to assess whether the proposed credit agreement is adapted to his needs and to his financial situation, where appropriate by explaining the pre-contractual information to be provided in accordance with paragraph 1, the essential characteristics of the products proposed and the specific effects they may have on the consumer, including the consequences of default in payment by the consumer". Implementing measures may be considered in the event a legislative instrument is chosen to clarify how this requirement could be fulfilled.

3.6.1.3. Option 1.3: Principles-based advice standards

The Commission could pursue the introduction of principles-based advice standards that all advice providers will be obliged to comply with in the exercise of their duties (similar to MiFID, Article 19). These standards could consist of:

– acting honestly, fairly, and professionally in the best interests of the client;

– considering a sufficient selection of available credit agreements in the preparation of his recommendation, in accordance with professional criteria, in order to recommend the most suitable credit product for the consumer's needs, financial situation and personal circumstances;

– providing the relevant risk warnings concerning the mortgage credit product, especially if the client wishes to purchase a product that the advisor deems unsuitable.

557 Belgium, Denmark, Germany, Estonia, Italy, Latvia, Hungary, Malta, the Netherlands, Austria, Romania, Slovenia, Slovakia, Finland and Sweden.

3.6.1.4. Option 1.4: Requirement to provide mortgage advice

This option implies the introduction of a requirement on creditors and, where applicable, credit intermediaries, to provide advice to mortgage credit customers. This would entitle each and every customer to receive a personalised recommendation for a specific product that is suitable for him.

3.6.2. Restrictions on remuneration

3.6.2.1. Option 2.1: Do nothing

Doing nothing would mean that the existing remuneration structures will continue to exist, together with the asymmetry of interests that they give rise to. In particular, creditors and credit intermediaries will not be prevented from maintaining remuneration schemes that give rise to conflicts of interest such as volume-based commissions, different commission amounts for the sale of different products, and full commission payment at mortgage contract signature.

3.6.2.2. Option 2.2: Principles-based guidance on remuneration policies

The Commission could introduce a general requirement the manner in which creditors remunerate their staff and the credit intermediaries with whom they work does not impede their compliance with the obligation to act in accordance with the best interests of their clients. Implementing measures may be considered in the event a legislative instrument is chosen in order to clarify terms or concepts in the principles-based guidance.

3.6.2.3. Option 2.3: Specific rules on methods and levels of remuneration

The Commission could introduce restrictions on certain forms of remuneration, as a way to address the asymmetry of interests between clients and advisors.

– Volume-based commissions: Action in respect to this very common remuneration scheme could involve its outright prohibition, or the imposition of restrictions. Such restrictions could include declining marginal returns or no returns for the advisor for the amount of the loan that is above a certain LTV ratio.

– Different commission levels for different products: Action here could involve an outright prohibition, or restricting the ability of lenders to differentiate commissions for their products to a significant extent.

– Full commission upon signature: Action here could involve a prohibition of full payment of commission upon signing the mortgage agreement. Another way would be allow only a part of the commission to be paid at that stage. Then payment of the rest or the entire of the commission amount could be linked to the performance of the borrower – respecting his contractual duties on the repayment of the loan.

– The Commission could further pursue the introduction of a cap on the total amount of remuneration a mortgage advisor may receive from lenders for recommending and selling their mortgage products. This option could contribute to preventing lenders offering very high commissions for promoting the sale of risky products such as sub-prime mortgages.

3.7. Description of options for policy instruments

Each of the above options could be given effect through a variety of different policy instruments. These include a Commission Recommendation, industry self-regulation (Code of Conduct), and Community legislation in the form of a Regulation or Directive. Table 16 explores the feasibility of giving effect to each of our policy options through each of the available policy instruments.

Table 16: Advice – Policy options versus instruments

Policy options: content vs instrument	Self-regulation	Recommendation	Communication	Directive	Regulation
Mortgage advice					
1.1: Do nothing					
1.2: Requirement to provide adequate explanations (e.g. Article. 5(6) of the CCD)	X	X		X	X
1.3: Principles-based advice standards	X	X		X	X
1.4: A requirement to provide mortgage advice	X	X		X	X
Remuneration strategies					
2.1: Do nothing	X	X		X	X
2.2: Principles-based guidance on remuneration policies	X	X		X	X
2.3: Specific rules on methods and levels of remuneration	X	X		X	X

Doing nothing does not require the use of any policy instrument. Beyond that the possibility of doing nothing, as can be seen from Table 16, it is feasible to give effect to any of the policy options through any of the five policy instruments except via a Communication. This is because of the very nature of a Communication: it is a tool used simply to communicate information to the Member States, in contrast to the rest of the instruments that, once adopted, operate to effect a particular change in the way things are done. The following sections will assess the impact of the policy options and will describe which policy instrument is the most appropriate to use, as well as the underlying reasons for the choice.

3.8. Assessment of policy options

3.8.1. Mortgage advice

3.8.1.1. Option 1.1: Do nothing

Effectiveness of policy option

Doing nothing would be ineffective with respect to the achievement of the objectives pursued by this initiative.

Impacts of policy option on stakeholders and efficiency

Doing nothing would mean that all the problems identified above remain. The risk that consumers are provided with advice which is not objective, impartial and in their best interests will remain. This means that consumers will continue to run the risk of being advised to purchase unsuitable products that could potentially lead them towards overindebtedness, default, and foreclosure. Moreover, consumers' trust towards the explanations and advice they receive –which was found to be relatively low – will not improve, nor will the existing information asymmetries or consumer confidence. In addition, difficulties and confusion over the different levels of protection in the Member States will continue to burden consumers. Doing nothing is therefore also detrimental in terms of consumer mobility and cross-border shopping.

With respect to the creation of a level-playing field, this option will, on the one hand, result in the maintenance of an unlevel playing field where creditors and credit intermediaries providing mortgage advice are confronted with different rules across the EU. Cross-border business will not be facilitated because the divergent rules and practices of Member States will lead to additional costs for creditors and credit intermediaries operating cross-border which will in turn act as a dissuading factor. On the other hand, under this option, creditors and credit intermediaries will not incur any one-off or recurring costs associated with the introduction of new rules on the provision of explanations and/or advice.

As far as Member States are concerned, it is expected that the option will also be to their disadvantage. While Member States' administrations will not incur any costs for introducing and enforcing new rules, there could be large social and economic costs associated with the unaddressed risk of consumers who receive unsuitable advice and/or no explanations, suffer detriment and, in the worst case scenario, become overindebted, default, and lose their home.

It follows that this option would neither contribute to the creation of a single market with a high level of consumer protection, nor to the general objective of a financial stable market for mortgage market.

3.8.1.2. Option 1.2: Requirement to provide adequate explanations

Effectiveness of policy option

The introduction of a requirement for creditors and credit intermediaries to provide adequate explanations, similar to Article 5(6) of the CCD, would be only of limited effectiveness in respect to the objective of ensuring objective, impartial advice that is in the consumer's best interest. This is simply because explanations are distinct from advice. This option would be effective however in respect to reducing information asymmetries and improving consumer awareness and understanding of the product being offered, and confidence in the product and creditor/credit intermediary. This could in turn, promote intra-state and cross-border customer mobility; consumers who are confident enough are likely to be more willing to shop around, attempt better deals, switch providers, and be mobile in general. Customer mobility will also be facilitated by the fact that all consumers will be entitled to the same right relating to the provision of adequate explanations, regardless of which Member State they are shopping around in. Financial stability will also be promoted: the receipt of adequate explanations will allow consumers to better understand the features, functions, and risks of the products they can choose from and make better choices that are less likely to result in financial detriment or distress. Furthermore, this option will ensure a level-playing field across the EU that will facilitate cross-border business by creditors and credit intermediaries.

Impacts of policy option on stakeholders and efficiency

The receipt of explanations should improve consumer awareness and understanding, leading to the choice of more suitable products. This can lead to a reduction in the risk of overindebtedness, and even defaults and foreclosures. The value of these benefits is estimated at EUR 40–56 million. There would also be an impact on confidence and mobility through the increased transparency.[558]

Concerning the impacts on creditors and/or credit intermediaries, the costs are likely to be moderate.[559] It is expected that they will have to incur one-off costs associated with training and the introduction of new rules and systems/Standard Operating Procedures amounting to approximately EUR 25 million, as well as recurring costs associated with the cost of providing explanations amounting to approximately EUR 13–25 million. It is noted that these figures take account of the fact that 22 Member States already have a specific requirement for the provision of explanations, either through application of the CCD to mortgage credit or through other binding or non-binding rules, which reduces the costs significantly. In case the policy instrument chosen is self-regulation, the costs will most probably lie at the lower end of the above mentioned ranges[560]. Creditors and/or credit intermediaries will also face certain benefits. Cross-border business will, in theory, be facilitated because divergent rules and practices with respect to this issue in Member States will be removed, creating a level playing field and legal certainty as well as increased opportunities for economies of scale and scope both domestically and cross-border. However, it is unlikely that the creation of a level playing field in this area alone would lead to lenders seeking out business cross-border.

The overall impact on Member States is expected to be positive. The costs to Member States' administrations in case binding legislation is selected as the preferred policy instrument would be relatively low given that 15 Member States already apply or intend to apply Article 5(6) of the Consumer Credit Directive to mortgage credit and five Member States already have binding rules in place requiring the provision of adequate explanations.[561] Estimates by Commission services are that the one-off and recurring costs will amount to about EUR 0.2 million and EUR 0.2–0.5 million respectively. Estimates by a recent external study however put the costs at somewhat higher: total costs faced by regulators are put at EUR 10.5 million.[562]

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558 "Adequate explanations and specific risk warnings will have lesser impact on customer mobility if financial incentives for switching remain unaffected", *Study on the Costs and Benefits of Mortgage Credit*, see footnote 136.

559 See footnote 136, *Study on the Costs and Benefits of Mortgage Credit*. The costs can be even more reduced in case where a number of Member States that have no provisions on this issue extend the relevant provision of the CCD Article 5(6) to mortgage credit.

560 This is because universal agreement and adherence is difficult to implement, enforce, and supervise, and also because binding national rules may prevent adherence to the non-binding instrument. See Section 3.9 'Policy instruments'.

561 Fifteen Member States (Belgium, Denmark, Germany, Estonia, Italy, Latvia, Hungary, Malta, the Netherlands, Austria, Romania, Slovenia, Slovakia, Finland and Sweden) apply or intend to apply Article 5(6) of the CCD to mortgage credit. Source: Commission survey of Member States. In Czech Republic, Ireland, Greece, Spain and Portugal there are legal obligations for creditors and sometimes intermediaries to provide explanations. See footnote 136.

562 See footnote 136.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 40–56 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 2.5–3.5 basis points due to the consumer receiving adequate explanations of the characteristics of the product that they are being offered.

– This is equivalent to mortgages of EUR 40–56 million[563].

– This figure incorporates a discount reflecting the fact that 22 Member States[564] either apply the CCD to mortgage credit or have similar binding or non-binding rules in place.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[565].

Consumers will also benefit in terms of increased customer mobility and increased competition between providers. Similarly, there will be some, albeit most likely, limited benefits to creditors and credit intermediaries in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5, these benefits are difficult to quantify.

Creditors and credit intermediaries will face EUR 25 million in one-off costs and between EUR 13–25 million in annual recurring costs. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[566]. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 25 million. This is based on the assumption that each credit institution must provide 8 hours of training to 20 % of its staff and each credit intermediary must provide 8 hours of training to 80 % of its staff[567]; also that each credit institution/credit intermediary requires 10 man hours per institution to create, prepare, configure new IT systems and Standard Operating Procedures and staff training.

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563 See footnote 277.

564 Fifteen Member States (Belgium, Denmark, Germany, Estonia, Italy, Latvia, Hungary, Malta, the Netherlands, Austria, Romania, Slovenia, Slovakia, Finland and Sweden) apply or intend to apply Article 5(6) of the CCD to mortgage credit. Source: Commission survey of Member States. In Czech Republic, Ireland, Greece, Spain and Portugal there are legal obligations for creditors and sometimes intermediaries to provide explanations. In Luxembourg, self-regulatory obligations state that adequate explanations should be provided. In Poland, a non-binding recommendation states that creditors (but not intermediaries) should provide adequate explanations. See footnote 136.

565 See footnote 268.

566 See footnote 268.

567 This reflects the fact that credit institutions are larger than credit intermediaries and thus have a small percentage of their staff dealing with these issues.

– Annual recurring costs are estimated at EUR 13–25 million. This is based on the assumption are based on the assumption that the provision of adequate explanations requires 0.5 hours to one hour per mortgage contract (the number of mortgage contracts affect is equal to 70 % of the total number of mortgage transactions)[568].

– These figures incorporate a discount reflecting the fact that 22 Member States[569] either apply the CCD to mortgage credit or have similar binding or non-binding rules in place.

According to Commission services' estimates Member States will face one-off costs of EUR 0.2 million and annual recurring costs of EUR 0.2–0.5 million. These costs can be broken down as follows.

– One-off costs of EUR 0.2 million. This is based on the assumption in a recent study[570] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, seven Member States[571] would have to introduce rules on adequate explanations.

– Recurring costs of EUR 0.2–0.5 million. These based on the assumption that the administrations incur costs for monitoring and enforcing the rules equal to between 1 and 3 man hours per institution.

– This figure incorporates a discount reflecting the fact that 15 Member States already apply or intend to apply Article 5(6) of the Consumer Credit Directive to mortgage credit and five Member States already have binding rules in place requiring the provision of adequate explanations.[572]

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

The EUR 10.5 million is quoted in an external cost benefit analysis[573] is based on the following assumptions.

– The figure is a NPV of regulator costs over a 15-year period from 2009 to 2014.

– The one-off and annual recurring costs are based on the results of a questionnaire to regulators. As relatively few quantitative responses were received, the highest figures received are applied to all countries to generate an upper bound of the likely cost. For this policy option, one-off costs are estimated at EUR 23 529 and annual recurring costs are estimated at EUR 30 000. Annual cost estimates were discounted using a real interest rate of 4 %.

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568 Based on an online survey of 2 500 individuals in 2006. On average in the EU, approximately 70 % of mortgage sales are accompanied by advice. *European Mortgage Distribution: changing channel choices*, Fortis, EFMA and Oliver Wyman, 2007.
569 See footnote 564.
570 See footnote 136.
571 Bulgaria, France, Cyprus, Lithuania, Luxembourg, Poland and the United Kingdom.
572 See footnote 561.
573 See footnote 136.

– The difference between the results of the external cost benefit analysis and that of Commission services appears to largely reflect the fact that the study assumed that only 16 Member States had similar rules in place.[574]

3.8.1.3. Option 1.3: Principles-based advice standards

Effectiveness of policy option

The introduction of advice standards is expected to be effective in achieving the objectives pursued. This is particularly the case in respect to the objective of ensuring that consumers receive objective, impartial advice that is suitable for them and in their best interests. This is because every creditor and credit intermediary would be required (in case a binding instrument is chosen) to adhere to standards that impose duties of objectivity, impartiality, suitability, acting in the client's best interest, etc. This will reduce the risk of consumers receiving unsuitable advice and the associated risk of becoming overindebted, and even suffering defaults and foreclosures, thus also promoting financial stability. The option is also expected to raise consumer confidence because, in knowing about the existence of clear standards that the advisors must meet, consumers have greater trust in the quality and reliability of the advice they receive. Moreover, under this option consumers across the EU will enjoy the same level of protection when receiving advice. Consumers will thus be less intimidated in engaging in cross-border shopping in the knowledge of the common level of protection they are afforded. It should however be noted that the effectiveness of this option would be strongly dependent on the instrument chosen. A recent study[575] found that high level principles such as those described under this policy option are viewed as lacking in credibility during financial crises, particularly if implemented through a Code of Conduct[576], and thus have less of an impact.

This option also facilitates the creation of a level-playing field, as it introduces EU-wide standards that all providers must comply with, and thus substantially eliminates barriers to cross-border business for creditors and credit intermediaries providing advice.

Impacts of policy option on stakeholders and efficiency

The impact on consumers under this option is expected to be positive. Society as a whole will also benefit from the expected reduced risk of overindebtedness, defaults, and foreclosures that this option carries. This translates to a positive impact of approximately EUR 58–77 million as it reduces the likelihood of financial instability and social unrest.

Creditors and credit intermediaries are expected to incur one-off costs associated with training and the introduction of new rules and systems/Standard Operating Procedures on the provision of advice, as well as certain annual recurring costs such as compliance costs and the costs of complying with the action (e.g. documenting information). It is estimated that the one-off and annual recurring costs will amount to approximately EUR 30 million and EUR 15–30 million respectively. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[577].

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574 See footnote 136.

575 See footnote 136.

576 "Historically both in the US and Europe (UK Mortgage Code) such general provisions stood at the beginning of intermediary regulation". See footnote 136.

577 See footnote 560.

These costs are qualified to a certain extent by the fact that in 17 Member States already have a legal requirement and four Member States have self-regulatory provisions to act honestly, professionally, and in the best interest of the client.[578] Credit intermediaries would however face higher costs than creditors due to the fact that their business is currently less regulated than that of creditors.[579] It is also possible that creditors and/or credit intermediaries would pass these costs to the consumers in terms of higher prices. Cross-border business would however be facilitated because barriers arising from divergent rules and practices will be removed. Creditors and credit intermediaries will face less costs when going cross-border.

Certain costs for Member States' administrations associated with the introduction and enforcement of new rules will have to be incurred in case a binding instrument is chosen, but they will be qualified to the extent that similar binding rules already exist in 15 Member States. According to estimates by Commission services, Member States' administrations will incur one-off and annual recurring costs amounting to EUR 0.1 million and EUR 0.2–0.5 million respectively. Estimates by a recent external study however put the costs somewhat lower: total costs faced by regulators over a 15-year period from 2009–2015 are put at EUR 0.54 million.[580]

<u>Quantification of costs and benefits</u>

Consumers and society in general will face aggregate benefits of EUR 58–77 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 3–4 basis points due to the consumer receiving adequate explanations of the characteristics of the product that they are being offered.

– This is equivalent to mortgages of EUR 58–77 million[581].

– This figure incorporates a discount reflecting the fact that 21 Member States[582] either binding or non-binding rules in place which require firms to act in the best interest of the clients.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[583].

Consumers will also benefit in terms of increased customer mobility and increased competition between providers. Similarly, there will be some benefits to creditors and credit intermediaries in the form of increased opportunities for economies of scale and scope both

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578 See footnote 136.
579 See footnote 136.
580 See footnote 136.
581 See footnote 277.
582 Seventeen Member States (Czech Republic, Denmark, Germany, Estonia, Ireland, Spain, France, Italy, Latvia, Hungary, the Netherlands, Poland, Portugal, Slovakia, Finland, Sweden and the United Kingdom) are identified as having legal requirements specifically for mortgage credit for firms to act in the best interest of clients. Four Member States (Belgium, Bulgaria, Greece and Cyprus) have industry self-regulation which has similar requirements.
583 See footnote 268.

domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors and credit intermediaries will face one-off costs of EUR 30 million and annual recurring costs of EUR 15–30 million. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[584]. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 30 million. This is based on the assumption that each credit institution must provide 8 hours training to 20 % of its staff and each credit intermediary 8 hours training for 80 % of its staff. It is also based on the assumption that each institution requires 10 man hours to create, prepare, configure new IT systems and standard operating procedures.

– Annual recurring costs are estimated at EUR 15–30 million. This is based on the assumption are based on the assumption that the provision of adequate explanations requires 0.5 hours to one hour per mortgage contract (the number of mortgage contracts affect is equal to 70 % of the total number of mortgage transactions)[585].

– This figure incorporates a discount reflecting the fact that 21 Member States[586] either binding or non-binding rules in place which require firms to act in the best interest of the clients.

According to Commission services' estimates Member States will face EUR 0.2 million in one-off costs and EUR 0.2–0.5 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.2 million. This is based on the assumption in a recent study[587] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, ten Member States[588] would have to introduce rules on adequate explanations.

– Annual recurring costs of EUR 0.2–0.5 million. These based on the assumption that the administrations incur costs equivalent to 1–3 man hours per institution.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

The EUR 0.54 million is quoted in an external cost benefit analysis[589] is based on the following assumptions.

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584 See footnote 268.

585 On average in the EU, approximately 70 % of mortgage sales are accompanied by advice. Based on an online survey of 2 500 individuals in 2006. *European Mortgage Distribution: changing channel choices*, Fortis, EFMA and Oliver Wyman, 2007.

586 See footnote 582.

587 See footnote 136.

588 Ten Member States will have to introduce laws: Spain, Lithuania, Luxembourg, Malta, Romania and Slovenia who have no rules in place; Belgium, Bulgaria, Greece and Cyprus who have self-regulation in place.

589 See footnote 136.

– The figure is a NPV of regulator costs over a 15-year period from 2009 to 2014.

– The one-off and annual recurring costs are based on the results of a questionnaire to regulators. As relatively few quantitative responses were received, the highest figures received are applied to all countries to generate an upper bound of the likely cost. For this policy option, one-off costs are estimated at EUR 23 529 and annual recurring costs are estimated at EUR 0. Annual cost estimates were discounted using a real interest rate of 4 %.

– The difference between the results of the external cost benefit analysis and that of Commission services most likely reflect the fact that the study assumed that only 18 Member States had similar rules in place and thus nine Member States (instead of ten) have to introduce rules as well as the fact that under this model there are no annual recurring costs.[590]

3.8.1.4. Option 1.4: Requirement to provide mortgage advice

Effectiveness of policy option

For consumers, an obligation to receive advice would ensure that a consumer receives a clear recommendation for one or more suitable products. This recommendation would ensure that these products meet a consumer's individual needs and circumstances. This could prove useful in particular for certain groups of consumers such as first time buyers or the self-employed as well as with vulnerable groups of consumers such as those with low levels of financial literacy and on low incomes. However, not all consumers (e.g. more experienced or financially literate consumers) may need or even want advice for different reasons (e.g. because it is time consuming or because it may increase costs), but all will receive it and might have to pay for it. Consequently, for consumers the price of mortgage credit could increase.

Creditors would only be able to provide advice on the best products for a consumer's needs from within their own product range and not for the market as a whole. The same applies for tied credit intermediaries. Moreover, as the statistics in Section 3.1 illustrate, a large number of consumers do not actually trust advice when it is provided by their creditor. Furthermore, advice potentially has a cost. If creditors were obliged to give advice, this would increase creditors' and credit intermediaries' costs which would feed into the overall cost of the mortgage lending process and raise prices for consumers. Moreover, a market for the provision of independent advice exists. There is a risk that companies, including many independent credit intermediaries, who specialise in providing advice, in particular independent advice, without necessarily actually offering the mortgage product, lose their business as consumers would be getting their advice automatically from the creditor. By leaving this market open, competition between providers of financial advice would be promoted. Competition between providers would leave open the scope for providers of advice, be they tied or independent credit intermediaries or creditors, to offer their services at low prices, or potentially even for free, if they were trying to attract customers. It would however be for the market to determine the price. By leaving it to the market, it would be the decision of the creditor to choose whether they want to engage in the market for financial advice or not and thus whether those costs were worthwhile. Consumers would also be free to

[590] See footnote 136.

choose whether they would like to receive advice and – possibly – incur the corresponding cost or whether they are confident in their own decision. More experienced or financially savvy consumers could then decide not to opt for advice.

It is nonetheless expected that this option could substantially reduce the risk of consumers, particularly vulnerable consumers, purchasing unsuitable products and thus the risk of overindebtedness, defaults, and foreclosures. It is therefore also expected to reduce the risk of overall financial instability. However, it may also have a detrimental impact on the level of competition in the market not only for advice but for mortgage credit.

Impacts of policy option on stakeholders and efficiency

The impact on creditors and credit intermediaries is expected to be negative. As the provision of advice carries a cost, all creditors and credit intermediaries (in case binding legislation is adopted) would incur substantial costs in order to provide such advice to every single mortgage credit customer. As these costs would be passed on to the consumer, this option is expected to increase the overall cost of mortgage credit, thereby negatively impacting both creditors and credit intermediaries (less business) and consumers (higher cost of credit). In addition, many creditors and credit intermediaries who do not at present provide advice, would incur costs for introducing this service or outsourcing it. Another cost relates to the fact that a market for the provision of independent advice already exists (IFAs[591]). There is a risk that companies, including many credit intermediaries who specialise in providing advice, in particular independent advice, without necessarily actually offering the mortgage product, lose their business. This would undermine competition in the area of advice provision and potentially have a negative impact on the quality of advice provided.

The monetary value of the costs to creditors and credit intermediaries under this option is expected to amount to EUR 137 million for one-off costs, and EUR 97–194 million for annual recurring costs. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges.

However, the reduced likelihood of borrower overindebtedness, default, and foreclosures constitutes a beneficial impact not only for consumers but for the society as a whole in terms of overall financial and social stability. This represents mortgages of a gross value of EUR 498–622 million. This particularly high figure however should be qualified by the loss of revenues that will result from passing the extra costs of compulsory advice to consumers.

As far as Member States' administrations are concerned, in case the instrument chosen is binding legislation, they are expected to incur one-off costs for introducing the requirement, and annual recurring costs for oversight and enforcement. These costs are expected to amount to approximately EUR 0.6 million and EUR 0.76–2 million respectively.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 498–622 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

591 IFA: Independent Financial Advisors.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 4–5 basis points due to the consumer receiving advice on the best products for their needs.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[592].

Consumers will however face costs in the form of a higher price for mortgage credit. These costs are difficult to estimate. However it can be assumed that the annual recurring costs of providing advice faced by creditor and intermediaries (described below) will be passed onto consumers in the form of higher prices. These higher prices will lead to some consumers, particularly those on lower incomes or first time borrowers, to face difficulties in obtaining a mortgage credit. The cost for consumers is therefore assumed to be equal to the annual recurring cost for creditors and credit intermediaries: EUR 97–194 million.

Creditors and credit intermediaries will face one-off costs of EUR 137 million and annual recurring costs of EUR 97–194 million. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[593]. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 137 million for establishment of new IT procedures, the development of new Standard Operating Procedures and staff training. This is based on the assumption that each credit institution must provide 8 hours training to 20 % of its staff and each credit intermediary 8 hours training for 80 % of its staff. It is also based on the assumption that each institution requires 10 man hours to create, prepare, configure new IT systems and Standard Operating Procedures.

– Annual recurring costs are estimated at EUR 97–194 million. This is based on the assumption that advice would have to be provided alongside all mortgage transactions. It is also assumed that it will take between 0.5–1 hours to provide mortgage advice.

Member States will face EUR 0.6 million in one-off costs and EUR 0.7–2 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[594] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, all 27 Member States would have to introduce rules on to ensure the obligatory provision of advice with all mortgage sales.

– Annual recurring costs of EUR 0.7–2 million. These based on the assumption that the administrations incur costs equivalent to 1–3 man hours per institution.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

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592 See footnote 268.
593 See footnote 268.
594 See footnote 136.

3.8.2. *Restrictions on remuneration*

3.8.2.1. Option 2.1: Do nothing

<u>Effectiveness of policy option</u>

Doing nothing in respect to advisors' remuneration schemes would not be effective in achieving the objectives pursued. In particular, remuneration schemes such as volume-based commissions, different commission levels for different products, and full commission payment upon signature of the mortgage contract would remain unaffected. This means that the misaligned incentives for advisors caused by these structures will remain unaddressed. Thus the risk of receiving unsuitable advice and consumers facing detriment by being sold an inappropriate product also remains unaddressed.

This option is also ineffective with respect to promoting cross-border mobility and a level playing field across Europe. The existence of diverging national rules means that cross-border business is likely to be discouraged; and consumers across the EU will not be afforded the same level of protection. Furthermore, this option is ineffective in reducing any existing risks to the overall financial and social stability. This is because it does nothing to address the perverse incentives caused by these remuneration schemes that could lead to overindebtedness, defaults, and repossessions.

<u>Impacts of policy option on stakeholders and efficiency</u>

Providers will not be impacted because the status quo is maintained and they will not be required to incur any costs relating to the introduction of new rules. Concerning the impacts on consumers, retaining the status quo means doing nothing to address the risk that they may end up with unsuitable products and suffer detriment. Creditors and credit intermediaries would not face any costs in modifying remuneration structures and employees would be able to retain their current remuneration structures. Member States administration, would not incur any costs associated with taking some sort of action on the issue. At the same time, the fact that the option does nothing to reduce the risk of overindebtedness, defaults, and foreclosures flowing from the existing remuneration schemes, weighs negatively on society as a whole.

3.8.2.2. Option 2.2: Principles-based rules on remuneration policies

<u>Effectiveness of policy option</u>

This option aims to tackle remuneration schemes that can create strong perverse incentives for creditors and credit intermediaries and that are likely to cause consumer detriment. It is expected that this option would be effective in achieving the objectives pursued. In particular, credit intermediaries and creditors would need to refrain from setting up schemes that lead to misaligned incentives. As such, the misaligned incentives caused by these schemes should be substantially reduced. Thus the risk of receiving unsuitable advice and thus the risk of consumer detriment should also diminish. The potential for less unsuitable products being purchased, particularly by vulnerable groups such as those on low incomes and/or with low levels of financial literacy, and thus a less likelihood for overindebtedness, defaults and foreclosures constitutes an important positive effect on EU-wide financial stability. Increased consumer confidence and the greater certainty that they are less likely to be mis-sold a product could also foster customer mobility both domestically and, albeit to a lesser extent, internationally.

This expected benefit however is somewhat qualified by the fact that the requirement is very high-level and does not specify what exactly would be needed in order to determine whether a particular remuneration scheme is acceptable or not or indeed who would make that determination. To argue that all instances of potential, apparent, or actual conflict of interest caused by remuneration schemes lead to the scheme being deemed unacceptable, would be naïve. It therefore follows that determining what is acceptable or not would probably depend on an assessment of the risk that consumers obtain unsuitable advice because of the misaligned incentives caused by the scheme. This means that a substantial margin of appreciation remains, which can lead to different interpretations either between Member States or between creditors and credit intermediaries about what is acceptable or not. These different interpretations can result in an unlevel playing field with varying degrees of effectiveness. At the same time, this option would allow firms the flexibility to comply with the principles in a way that is appropriate to their size and internal organisation and the nature, scope and complexity of their activities.

While this option does facilitate to a degree the creation of a level-playing field across Europe that could promote cross-border mobility of businesses and consumers, the aforementioned wide margin of discretion prevents its full realisation.

Impacts of policy option on stakeholders and efficiency

Consumers and society as a whole will substantially benefit from the expected reduction in the risk of overindebtedness, defaults, and foreclosures flowing from the existing remuneration schemes and the perverse incentives they create on advisors. This latter effect has clear positive impacts on overall financial and social stability of between EUR 349–523 million. Consumers will also benefit in terms of increased customer mobility and increased competition between providers.

Creditors and credit intermediaries are expected to be negatively impacted. They will incur one-off costs mainly relating to substantial changes to the design and operation of remuneration schemes. It is expected that these will amount to approximately EUR 3 million for establishment of new schemes and the development of new Standard Operating Procedures and staff training. Additionally, there is a small likelihood that employees providing advice suffer a small revenue reduction due to the fact that (i) they may not be able to increase revenue by maximising the sale of products that provide the highest commission, and (ii) they may not be able to increase revenue by increasing the size of the loans provided (the case in volume-based commissions). These costs are not quantifiable. There are also more general impacts on creditors who will no longer be able to promote their own products when selling through intermediaries by offering higher levels of remuneration for specific products and will therefore be subject to more transparent competition. These costs are not quantifiable. A further source of potential detriment for creditors and credit intermediaries relates to the fact that this option is very high-level and does not specify what kind of remuneration scheme would be deemed appropriate or not. Creditors and credit intermediaries may thus have to incur costs to set up new schemes to comply with the obligation and still be found as maintaining an inappropriate scheme. It should be noted that for credit institutions, changing the remuneration system will not necessary increase the cost of remuneration (only the way the distribution is remunerated), so it would not affect remuneration levels directly. Creditors in particular are likely to also benefit from the fact that they will no longer run the risk of adverse selection on the part of credit intermediaries.

Member State administrations will need to incur certain costs relating to the introduction and enforcement of new rules in case the policy instrument chosen is binding legislation. It is assumed that the administrations' one-off costs would amount to EUR 0.6 million and annual recurring costs to EUR 0.7–2 million.

<u>Quantification of costs and benefits</u>

Consumers and society in general will face aggregate benefits of EUR 349–523 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 4–6 basis points due to the consumer being sold a more appropriate product.

– This is equivalent to mortgages of EUR 349–523 million[595].

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[596].

Consumers will also benefit in terms of increased customer mobility and increased competition between providers. These benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5, these benefits are difficult to quantify.

Creditors and credit intermediaries will face EUR 3 million in one-off costs. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[597]. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 3 million. This is based on the assumption that that each credit institution/credit intermediary requires 4 man hours per institution to create, prepare, configure new IT systems and Standard Operating Procedures. It is also assumed that no staff training is required to modify salary structures.

– Annual recurring costs are estimated at EUR 0. This is based on the assumption that the monitoring of the salary framework is already in place and controlled under normal internal audit procedures.

Employees providing advice may suffer a small revenue reduction due to the fact that (i) they may not be able to increase revenue by maximising the sale of products that provide the highest commission, and (ii) they may not be able to increase revenue by increasing the size of the loans provided (the case in volume-based commissions). This cost is not quantifiable as it is uncertain to what employers would simply, for example, abolish commission-based sales and not compensate by raising employees base salary.

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595 See footnote 277.
596 See footnote 268.
597 See footnote 268.

Member States will face EUR 0.6 million in one-off costs and EUR 0.7–2 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[598] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that all 27 Member States would have to introduce rules to modify remuneration strategies.

– Annual recurring costs of EUR 0.7–2 million. These based on the assumption that the administrations incur costs equivalent to 1–3 man hours per institution.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

3.8.2.3. Option 2.3: Specific rules on methods and levels of remuneration

Effectiveness of policy option

This option involves the introduction of specific restrictions or caps on the methods and levels of the remuneration that the lender provides to the advisor. Its main distinction from the previous option is that it spells out in detail the sort of remuneration schemes and the level of remuneration that are not acceptable and are thus subject to restrictions or caps.

The option is expected to be effective in addressing misaligned incentives caused by the existing remuneration structures, thereby reducing the risk that consumers, particularly by vulnerable groups such as those on low incomes and/or with low levels of financial literacy, end up with unsuitable products and possibly suffering financial detriment. Consequently, this option is also expected to be effective in promoting overall financial stability, as it reduces the risk of consumers ending up with unsuitable products, and by implication reduces the risk that consumers, particularly vulnerable groups such as those on low incomes and/or with low levels of financial literacy, become overindebted, suffer defaults and foreclosures. Increased consumer confidence and the greater certainty that they are less likely to be mis-sold a product could also foster customer mobility both domestically and, albeit to a lesser extent, internationally.

This option also facilitates cross-border mobility and creates a level playing field: creditors and credit intermediaries are confronted with the same rules in each Member State and consumers are afforded the same level of protection across Europe (in case self-regulation is chosen as the preferred instrument, it is reasonable to assume a less than 100 % adherence to the voluntary code, thereby mitigating the positive effects of the option).

Impacts of policy option on stakeholders and efficiency

Consumers, and society as a whole, will benefit from an anticipated reduction in the risk of overindebtedness, defaults, and foreclosures flowing from the existing remuneration schemes and the perverse incentives they create on advisors. This latter effect has clear positive impacts on overall financial and social stability amounting to EUR 349–523 million. Increased consumer confidence and the greater certainty that they are less likely to be mis-

598 See footnote 136.

sold a product could also foster customer mobility both domestically and, albeit to a lesser extent, internationally.

The impact on creditors and credit intermediaries under this option is expected to be negative. Creditors and credit intermediaries will incur costs for revising and reconfiguring remuneration structures that comply with the specific requirements imposed. The Commission services expect that one-off costs would amount to approximately EUR 3 million. This figure is relatively low as the actual costs of amending systems for remuneration would be the same as the previous option. Where the options differ, however, is that other – less quantifiable – costs would be incurred under this option. Creditors in particular, may have to incur substantial costs to invent new and effective ways of promoting their products that do not breach the specific requirements. Also, the detail in the requirements will introduce substantial rigidity, in the sense that creditor may be prevented from setting up schemes that are only incompatible in form but not in substance. It is expected that this option will severely restrict the flexibility of creditors to choose and implement the method they deem most effective in promoting their products. Additionally, there is a small likelihood that employees providing advice suffer a small revenue reduction due to the fact that (i) they may not be able to increase revenue by maximising the sale of products that provide the highest commission, and (ii) they may not be able to increase revenue by increasing the size of the loans provided (the case in volume-based commissions). Creditors in particular are likely to also benefit from the fact that they will no longer run the risk of adverse selection on the part of credit intermediaries.

Member State administrations will need to incur certain costs relating to the introduction and enforcement of new rules in case the policy instrument chosen is binding legislation. It is assumed that the administrations' one-off set-up costs would amount to EUR 0.6 million and annual recurring costs to EUR 0.7–2 million.

<u>Quantification of costs and benefits</u>

Consumers and society in general will face aggregate benefits of EUR 349–523 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 4–6 basis points due to the consumer being sold a more appropriate product.

– This is equivalent to mortgages of EUR 349–523 million[599].

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[600].

Consumers will also benefit in terms of increased customer mobility and increased competition between providers. These benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5, these benefits are difficult to quantify.

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599 See footnote 277.
600 See footnote 268.

Creditors and credit intermediaries will face EUR 3 million in one-off costs. In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[601]. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 3 million. This is based on the assumption that that each credit institution/credit intermediary requires 4 man hours per institution to create, prepare, configure new IT systems and Standard Operating Procedures. It is also assumed that no staff training is required to modify salary structures.

– Annual recurring costs are estimated at EUR 0. This is based on the assumption that the monitoring of the salary framework is already in place and controlled under normal internal audit procedures.

Employees providing advice may suffer a small revenue reduction due to the fact that (i) they may not be able to increase revenue by maximising the sale of products that provide the highest commission, and (ii) they may not be able to increase revenue by increasing the size of the loans provided (the case in volume-based commissions). This cost is not quantifiable as it is uncertain to what employers would simply, for example, abolish commission-based sales and not compensate by raising employees base salary.

Member States will face EUR 0.6 million in one-off costs and EUR 0.7–2 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.64 million. This is based on the assumption in a recent study[602] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, it is assumed that all 27 Member States would have to introduce rules to modify remuneration strategies.

– Annual recurring costs of EUR 0.7–2 million. These based on the assumption that the administrations incur costs equivalent to 1–3 man hours per institution.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

3.8.2.4. Comparison of options for mortgage advice

The analysis of the options above clearly demonstrates that the objectives of this initiative cannot be achieved under the 'No action' scenario (Option 1.2). It has been shown that this option is not effective as it preserves the status quo and thus all the problems that have been identified in the problem section.

[601] See footnote 268.
[602] See footnote 136.

Table 17: Mortgage advice – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure that any mortgage credit advice provided to a consumer is objective, impartial and in the consumers' best interest	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1.1: Do nothing	0	0	0	0	0	0	0
1.2: Requirement to provide adequate explanations (e.g. Article 5(6) of the CCD)	✓	✓✓	✓	✓/0	✓/0	✓	✓
1.3: Principles-based advice standards	✓✓✓	✓✓✓/✓✓	✓✓	✓/0	✓/0	✓	✓✓
1.4: A requirement to provide mortgage advice	✓	✓✓✓	✓/0	0	0	✓	×

Option 1.2 was found to be beneficial for consumers, as well as for society as a whole; this is notwithstanding the fact that it was found to have a weak positive contribution in respect to the specific objective of ensuring objective, impartial and suitable advice. This is however due to the fact that it is not specifically addressing the issue of advice but focusing on explanations. As such, it can be combined with Options 1.3 and/or 1.4. However, given its positive impact on consumer confidence it would contribute to overall financial stability. At the same time, this option was found to have a slight positive effective in terms of facilitating cross-border mobility for and ensuring a level-playing field. This is due in principle to the creation of a level playing field.

Option 1.3 was also found to be even more beneficial for consumers, as well as having positive impacts on financial and social stability through a reduction in defaults. Importantly, this option scored well in its effectiveness in respect to the specific objective of ensuring objective, impartial and suitable advice. At the same time, the option was found to have a similar effect as Option 1.2 in terms of facilitating cross-border mobility for and ensuring a level-playing field.

Option 1.4 was found to be the most effective in terms of reducing the likelihood of consumer detriment and improving consumer confidence. A beneficial impact on consumers was found to exist, even after taking into account the impact of forcing advice onto customers that do not want it. This positive impact focuses more on vulnerable consumers such as those on low incomes or with low levels of financial literacy, whereas the negative affects are felt more by more experienced consumers. Concerning the specific objective of ensuring objective, impartial and suitable advice, the option was found to have a negligible effect as although this option would ensure the provision of advice, it would not ensure that the advice provided is of a sufficiently high quality. Option 1.4 can also be combined with Options 1.2 and/or 1.3 to ensure that a high quality of advice is provided. It was also found to be little or no effective in respect to the tackling of barriers to cross-border mobility and the creation of a level-playing field. Of particular relevance was the fact that this option was found to have strong negative impacts on providers and the market for advice in general.

Table 18: Mortgage advice – Impact on main stakeholders

Stakeholders/ Policy options on mortgage advertising & marketing	Consumers/society	Creditors and Credit intermediaries	Member States
1.1: Do nothing	0	0	0
1.2: Requirement to provide adequate explanations (e.g. Article 5(6) of the CCD)	✓✓	×	×
1.3: Principles-based advice standards	✓✓	0/×	×
1.4: A requirement to provide mortgage advice	✓✓✓	×××	××

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

A first conclusion to be drawn from this is that, despite its strong positive impact on consumer confidence, Option 1.4 is insufficiently effective in terms of achieving two other objectives, namely to ensure the provision of high quality advice as well as to facilitate cross-border mobility for consumers and creditors/credit intermediaries alike. Although Option 1.4 could be considered in conjunction with either Options 1.2 or 1.3, the negative impacts on stakeholders of this policy option are more significant; not only would creditors and credit intermediaries face significant costs, but the market for independent advice could be negatively impacted and consumers could find themselves paying higher interest rates to offset the costs, and those consumers who feel that advice is not required would be forced to receive it anyway.

The second conclusion to be drawn is that Option 1.3 is the most effective in meeting the objectives. It has very beneficial impacts on consumers, while the impact on providers would be weakly negative. Option 1.3 could also be combined with Option 1.2 as the provision of explanations to all consumers (Option 1.2) combined with the provision of advice according to certain standards to those consumers who want to receive it (Option 1.3) would be mutually reinforcing and ensure that all consumers who need a certain level of protection receive it and those who wish to receive advice can receive it in a high quality form. It follows that the two options taken together, lead to a regime where all consumers, whether in advised or non-advised sales are more likely to end up with suitable products, not suffer detriment, and grow in confidence. In conclusion, the preferred route consists of a combination of Options 1.2 and 1.3.

Table 19: Mortgage advice – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 1.1	Option 1.2	Option 1.3	Option 1.4
Consumer/social benefits:				
reduction in defaults(value of mortgages)[603]	0	40–56	58–77	498–622
increased mobility	0	Not quantifiable	Not quantifiable	Not quantifiable
Creditor/credit intermediary benefits:				
economies of scale and scope	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable
Total EU costs (million EUR)	**Option 1.1**	**Option 1.2**	**Option 1.3**	**Option 1.4**
Provider costs:				
one-off	0	25	30	137
recurring	0	13–25	15–30	97–194
Member State costs:				
one-off	0	0.2	0.1	0.6
recurring	0	0.2–0.5	0.5	0.7–2

3.8.2.5. Comparison of options for remuneration strategies

The analysis of the options above clearly demonstrates that the objectives of this initiative cannot be achieved under the 'Do nothing' scenario. It has been shown that this option is not effective as it preserves the status quo and thus all the problems that have been identified in the problem section.

Table 20: Remuneration – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure that any mortgage credit advice provided to a consumer is objective, impartial and in the consumers' best interest	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Principles-based guidance on remuneration policies	✓✓	✓✓	✓	✓	✓	✓	✓✓
2.3: Specific rules on methods and levels of remuneration	✓✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Option 2.2 was found to contribute to the achievement of the objectives pursued, and thus to reduce the risk that remuneration structures create misaligned incentives and lead to consumers, vulnerable groups such as those on low incomes and/or with low levels of financial literacy, are sold inappropriate products for their needs and circumstances. However, it was slightly less effective than Option 2.3 in tackling cross-border barriers to mobility and creating a level playing field. This is due to the fact that, under Option 2.2, uncertainty about whether particular remuneration structures would be allowed or not may create an unlevel playing field either between Member States or between creditors/credit intermediaries. In

603 See footnote 281.

terms of impacts on stakeholders, Option 2.2 was found to have a reasonably positive impact on consumers, and a weak negative impact on creditors and credit intermediaries. Additionally, there is a small likelihood (which is the same under Option 2.2 and 2.3) that employees providing advice suffer a small revenue reduction. The impact on Member States was estimated to slightly positive, when considering also the benefits to society as a whole.

Option 2.3 was found to be as effective as Option 2.2 in terms of benefits for consumers and society. This option was found to have a positive effect in respect to the achievement of the remaining objectives. Concerning impacts on stakeholders, it was found that the impact on consumers was positive, the same as Option 2.2 (this is due to the fact that it is assumed that both options will be equally effective if implemented properly in preventing remuneration strategies that lead to misaligned incentives). The impact on creditors and credit intermediaries however was found to be strongly negative; this was because, apart from the quantified one-off costs that creditors and credit intermediaries would incur and which are described above, there are also significant intangible negative impacts relating to loss of flexibility, discretion, means of promotion, etc.

Table 21: Remuneration – Impact on main stakeholders

Stakeholders/ Policy options on mortgage advertising & marketing	Consumers	Creditors and Credit intermediaries	Member States
2.1: Do nothing	0	0	0
2.2: Principles-based guidance on remuneration policies	✓✓	×	×
2.3: Specific rules on methods and levels of remuneration	✓✓	××	×

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

The analysis demonstrates that Option 2.3 clearly fares best in terms of effectiveness in comparison to Option 2.2. However, in terms of impacts on stakeholders, the picture differs. Both Options 2.2 and 2.3 have a similar impact in terms of consumers and Member States. In terms of quantifiable costs for creditors and credit intermediaries, the two options are also close. A similar intangible impact on employees is also expected. However, Option 2.3 has a particularly stronger negative impact on creditors and credit intermediaries, particularly when considering the intangible costs in the form of loss of flexibility, discretion, means of promotion, etc.

In conclusion, Option 2.2 is the preferred policy option. The difference in effectiveness compared to Option 2.3 is quite small; the difference in impacts, especially impacts on creditors and credit intermediaries larger. From the detailed qualitative and quantitative analysis, it can be clearly inferred that the disproportional detrimental effect on creditors and credit intermediaries under Option 2.3 justifies opting for another course of action, despite a potentially slight reduction in effectiveness. Option 2.2 substantially reduces the negative impact on creditors and credit intermediaries, while still remaining effective in achieving the pursued objectives.

Table 22: Remuneration – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 2.1	Option 2.2	Option 2.3
Consumer/social benefits: reduction in defaults(value of mortgages)[604] **Creditor/credit intermediary benefits:** savings and more business	0	349–523 Not quantifiable	349–523 Not quantifiable
Total EU costs (million EUR)	Option 2.1	Option 2.2	Option 2.3
Creditor/credit intermediary costs: one-off recurring **Member State costs:** one-off recurring	 0 0 0 0	 3 0 0.6 0	 3 0 0.6 0

3.9. Assessment of the policy instruments

3.9.1. Self-regulation

The preferred options could be pursued through the use of self-regulation. One of the stated benefits of self-regulation is that it is quick, flexible and may easily be modified to take into account market developments. Choosing self-regulation would represent an important signal as to the future credibility of this instrument in the field of retail financial services. It should be underscored however, that negotiations between the mortgage services industry and consumer representatives have proven to be extremely difficult, long, and resource consuming in the past, primarily due to the large divergence of opinions between the two parties on this issue. Given their shortage of resources, this problem is likely to be particularly acute for consumer representatives. A major concern is that a major part of the benefits of self-regulation become neutralised due to the aforementioned potential problems.

For self-regulation to be successful, adherence and implementation of the agreed code of conduct must be particularly high, near the 100 % level that exists in the case of binding legislation. Given the Commission's experience with the adherence and implementation of the *Voluntary Code of Conduct on Pre-Contractual Information for Home Loans*, it is believed that it is unlikely to arrive at adherence and implementation levels approximating 100 % across Europe. This is because some providers may refrain from signing a Code, while others may be unable to do so for fear of contravening national legislation, and others may sign but inadequately apply it. It is therefore unlikely that self-regulation will be an effective instrument in the achievement of the objectives under this initiative.

3.9.2. Non-binding Community instrument

A Commission Recommendation to Member States for the introduction of rules giving effect to the preferred policy options is unlikely to be effective in achieving the objectives pursued under this initiative. This is because some Member States are likely to refrain from implementing the recommendation into national law while others may be prevented by the existence of contravening national provisions and be reluctant to amend and/or abolish existing national provisions. It therefore follows that implementation is unlikely to reach at or near the 100 % level. This will result in a somewhat partial achievement of the objectives, with the extent of success largely dependent on how many Member States would decide to implement the Recommendation.

[604] See footnote 281.

3.9.3. *Binding Community instrument*

The introduction of binding community instrument is expected to be more effective in achieving the objectives pursued under this initiative. Only a binding Community instrument can guarantee that the requirements under each of the preferred options are introduced in every Member State and are adequately enforced through regulatory oversight and dissuasive sanctions for non-compliance. In contrast to the other instruments discussed, binding legislation should ensure 100 % adherence and implementation. Non-compliance would mean a contravention of the law. Thus a binding instrument would ensure a level playing field that promotes the mobility of businesses, consumer confidence and consumer mobility through the introduction of EU-wide rules on the provision of explanations and advice, and thus contribute to creating a competitive and efficient Single Market.

Adopting binding legislation is however particularly time consuming and costly. Member State administrations will incur costs for implementation, transposition (in case of a Directive) and enforcement. It is estimated that Member States will incur one-off costs of a maximum of between EUR 1.1–1.6 million and recurring costs of a maximum of between EUR 3.2–4.8 million, although synergies between the different policy options could eventually reduce these costs, for example these figures include the costs of three separate legislative initiatives, if combined, the costs could be substantially reduced.

Providers will need to incur costs for changing systems, standard operating procedures, and for employee training to comply with the new requirements. These costs however are mitigated, albeit to a limited extent, by the cost savings achieved by those providers engaged in cross-border business; the level playing field will allow them to avoid duplication and save from operational optimisation. It should be noted however, that while binding legislation involves certain costs, self-regulation and a recommendation would also involve very similar costs if anywhere near the 100 % level of adherence and implementation would be reached; providers will again have to incur costs for training and changing procedures and practices, albeit smaller given the likelihood of falling short of the 100 % level.

In general, the Commission has the choice between a Directive and a Regulation as a binding policy instrument. A Directive has, on the one hand, the advantage of allowing for a more flexible approach, enabling both minimum and maximum harmonisation within the same instrument and thus is able to take into account the specificities of national markets. A minimum harmonisation Directive would allow more flexibility to Member States than a maximum harmonisation Directive, which would reduce the possibilities for Member States to gold plate. A Regulation, on the other hand, theoretically allows achieving the highest level of harmonisation and standardisation in a shorter timeframe without the need for national transposition measures. It also enables private enforcement by consumers and business alike, thus bringing the single market closer to the citizen.

While a Directive approach with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national specificities of the market. A Directive could also, in theory, ensure maximum harmonisation in certain areas, while enabling minimum harmonisation in others. Such an approach would provide a degree of flexibility. It is therefore recommended to use the legal instrument of a Directive.

3.10. Impact on Community resources and impacts on third countries

The preferred policy options on mortgage advice do not have any impact on European Community resources.

Positive social impacts can be expected under this option. The option operates to substantially improve consumers' understanding and confidence, better protect them from purchasing unsuitable products, and reduce the likelihood of suffering detriments as a result of defaults on mortgage loans. It follows that the estimated reduction in defaults under this option confers an important social benefit to European consumers.

No impact on the environment can be expected from the policy proposals in the product suitability area.

With regard to the impact on third countries, the introduction of rules on mortgage advice and remuneration strategies will not lead to discrimination against creditors or credit intermediaries from third countries willing to offer their services on the EU territory as they would need to comply with the same rules. If the proposed Directive is extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway. Finally, no direct impact on other countries is to be expected.

3.11. Conclusion

The introduction of principles-based rules on mortgage advice and the remuneration of advisors is expected to address effectively the problems identified and generate positive impacts on the European mortgage market. The rules will help consumers across Europe to better understand products, make better choices, suffer less detriment be more empowered; and they will benefit businesses through the creation of opportunities for cross-border business and operational optimisation. In the context of the above analysis, it was found that these results would be better achieved through binding Community legislation, rather than through a non-binding Community instrument or industry self-regulation.

4. CREDITWORTHINESS AND SUITABILITY

4.1. Context

As experienced by several Member States in the run-up to the crisis[605], lending and borrowing decisions based on poor creditworthiness or suitability assessments may have severe adverse impacts on financial stability and the real economy.

In its report requested by the G20, the Joint Forum has found that "poorly underwritten residential mortgages contributed significantly to the financial crisis"[606] and recommended that "supervisors should ensure that mortgage originators adopt minimum underwriting

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605 See for instance *Review of the Differentiated Nature and Scope of Financial Regulation*, Joint Forum, 2010, or see footnote 136 for specific examples.

606 *Review of the Differentiated Nature and Scope of Financial Regulation*, Joint Forum, 2010.

standards that focus on each borrower's capacity to repay the obligation in a reasonable period of time."[607]

Hence, assessing the creditworthiness of the borrower is key in order to avert a repetition of past errors. However, ensuring that the mortgage credit is affordable for the borrower given her/his financial situation would not be enough to hinder future defaults on the credit. Risky products such as loans with 'teaser rates', foreign-exchange denominated loans, subprime, interest-only or self-certification mortgages have been taking a significant market share in some Member States without the borrowers having an adequate understanding of the products' risky features and their impacts[608]. It is therefore also important that the mortgage credit offered to the borrower is suitable when considering his/her needs and circumstances.

Assessing whether a mortgage credit is affordable or suitable for the borrower, however, requires not only a good knowledge of the credit product but also of the borrower. Having access to complete and up-to-date information is therefore an important pre-requisite to a thorough assessment.

4.2. Overview of the legislative framework

4.2.1. Creditworthiness assessments

The objective of assessing a borrower's creditworthiness is to ensure that that the borrower has sufficient financial capacity to meet his/her debt obligations and thus repay the loan. The information necessary to assess the borrowers' creditworthiness can be obtained through different means. For instance, creditors can consult a credit register to get information about the credit status of a borrower, they can obtain the information directly from the borrower, or they might already have a full picture of the financial situation of the borrower because the borrower has a long term financial relationship with him/her.

4.2.1.1. EU level

Although under the CCD, before granting a consumer credit, there is an explicit requirement to undertake a creditworthiness assessment, there is no such requirement for granting a mortgage loan.

The Capital Requirements Directive[609] obliges credit institutions to set aside funds to cover their lending activities. Under the standardised approach, the exposure value of an asset is its balance sheet value and the exposure class is determined by the nature of the exposure. In contrast, under the internal ratings-based approach, credit institutions can use their own rating system to determine their risk-weighted exposure.[610]

In the case of the assessment of residential mortgage lending under the standardised approach, a risk weight of 35 % can be assigned to the loan provided that the value of the property does not depend on the credit quality of the obligor, the risk of the borrower does not materially

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607 See footnote 606.

608 See *Summary of Responses to the public consultation on responsible lending and borrowing in the EU*, European Commission, 2009. See footnote 136 for further details.

609 The Capital Requirements Directive, comprising Directive 2006/48/EC and Directive 2006/49/EC, can be consulted at: http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#directive.

610 Article 84(2)(b) of the CRD.

depend on the performance of the underlying property and the value of the property exceeds the exposures by a substantial margin. The latter ceiling is typically set by regulators at a loan-to-value ratio of 80 %, but does vary across Member States. Mortgage loans not meeting these conditions normally attract a capital charge of 75 % (retail borrowers) or 100 %.[611] In the internal ratings-based approach, the credit institution has to calculate the risk weighted exposure with a formula using information about the 'probability of default' and the 'loss given default' of the type of loan, taking into account collateral. The 'probability of default' of the borrower should be based on the institution's assignment of each exposure to different grades, or pools, as part of the credit approval and monitoring processes.

4.2.1.2. Member State level

Different approaches are followed by Member States regarding the need or not to assess the creditworthiness of the borrower in the area of mortgage credit.

Table 23: Overview of requirements to assess consumer creditworthiness

Member State	Assessment of consumer creditworthiness
Austria	No legislative or regulatory requirement for creditors or credit intermediaries to assess creditworthiness or consult a creditworthiness database.
Belgium	Legislative requirement for creditors and credit intermediaries to assess creditworthiness. Creditors must (also) consult a creditworthiness database. No legal requirement for credit intermediaries to consult a creditworthiness database. However, there is a draft law which provides for credit intermediaries to assess creditworthiness on the basis of 'sufficient information', and the Minister of Economics could also provide for a duty of care such the credit intermediaries must also consult a creditworthiness database.
Bulgaria	Legal requirement for creditors, no requirement for credit intermediaries. No requirement to consult a credit database for either creditors or credit intermediaries.
Cyprus	Legal requirement for creditors. Reported as 'not relevant' for credit intermediaries. However, looking to other information sources, this is because credit intermediaries are not supervised or regulated (Europe Economics, 2009).
Czech Republic	Legal requirement for credit institutions. Does not apply to NCIs, or credit intermediaries. No requirement for any of the entities to check a credit database.
Germany	Currently, no requirement exists. However, there are industry guidelines provided by the German national banking association. From 2010, a legislative requirement for creditors; it will not include credit intermediaries. Post 2010, legal requirement to consult credit database 'if necessary'.
Denmark	No legislative requirement for either creditors or credit intermediaries. No requirement to consult a credit database. No industry recommendations or guidelines.
Estonia	Legal requirement for creditors but not for credit intermediaries. No requirement for either creditors or credit intermediaries to consult a credit database.
Greece	Legal requirement for creditors. Credit intermediaries do not assess creditworthiness.
Spain	No legislative requirement for creditors or credit intermediaries to assess the creditworthiness of consumers. No requirement for either creditors or credit intermediaries to consult a credit database.
Finland	Legal requirement for creditors. No requirement for credit intermediaries.
France	No legislative requirement or industry guidelines. Credit intermediaries are not required to assess creditworthiness in France.
Hungary	Legislative requirement for creditors. N o requirement for credit intermediaries. No requirement to consult a creditworthiness database for either creditors or credit intermediaries.
Ireland	Legislative requirement for creditors and credit intermediaries. However, no legal requirement to consult a credit data base.
Italy	Legislative requirement for creditors. No requirement for credit intermediaries. No requirement for either creditors or credit intermediaries to consult a credit database.

611 See footnote 609.

Lithuania	Legal requirement for creditors. No requirement for credit intermediaries as credit intermediaries cannot conclude credit contracts. No requirement for creditors to consult a credit database.
Luxembourg	No requirement for creditors. No requirement to consult a credit database.
Latvia	Legal requirement for creditors. No requirement for credit intermediaries. No requirement to consult a credit database.
Malta	No information provided
Netherlands	Legal requirement to assess creditworthiness by both creditors and credit intermediaries. Legal requirement to consult a creditworthiness database for creditors and credit intermediaries.
Poland	Legislative requirement for creditors. No requirement for credit intermediaries. No requirement to consult a credit database.
Portugal	No legislative requirement for creditors or credit intermediaries to assess creditworthiness. No legislative requirement for creditors or credit intermediaries to check a credit database. No industry recommendations or guidelines.
Romania	Legal requirement for creditors and credit intermediaries. No requirement to consult a credit database
Sweden	Legal requirement for creditors and credit intermediaries. No requirement to consult a credit database.
Slovenia	Legal requirement for credit institutions and 'savings banks'. No requirement to consult a creditworthiness database.
Slovakia	No legal requirement.
United Kingdom	Legislative requirement for creditors. Legislative requirement for credit intermediaries only if they provide advice. No legal requirement to consult a credit database.

Source: London Economics, November 2009.

In some cases, legal requirements go beyond the obligation to carry out a creditworthiness assessment. For example, Belgian law prohibits the lender from granting consumer credit if, having regard to the information that it has or should have at its disposal, it considers that the consumer will be unable to repay.[612] In the United Kingdom, creditors need to have a written responsible lending policy in place setting out the factors that they will take into account in assessing a customer's ability to repay. Creditors must also keep an adequate record to demonstrate that they have taken account of the customer's ability to repay.[613]

Despite Member States' different approaches, some convergence can be expected following the implementation of the CCD. In its Article 8, the CCD stipulates that creditors must carry out an assessment of the borrower's creditworthiness before the conclusion of the consumer credit agreement[614]. A survey conducted by Commission services in January 2009 found that 17 Member States (Austria, Belgium, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany, Hungary, Italy, Latvia, the Netherlands, Romania, Slovakia, Slovenia, Malta and Sweden) and Norway have decided to apply Article 8 to mortgage credit. Out of the ten remaining Member States, six of them (Czech Republic, Greece, Ireland, Lithuania[615], Poland and the United Kingdom[616]), as showed in the table above, have already similar provisions. Based on the table above, only Spain, France, Luxembourg and Portugal do not have any provisions in place.

612 Article 15 of the Belgian Act of 12.6.1991 concerning consumer credit.

613 *Mortgage and Home Finance: Conduct of Business Sourcebook*, UK Financial Services Authority, MCOB 11.3 Responsible lending, and responsible financing of home purchase plans, http://fsahandbook.info/FSA/html/handbook/MCOB/11/3.

614 See footnote 254, Article 8.

615 However laws regulating the activities of commercial banks require evaluating the financial possibilities of consumers.

616 However firms must lend responsibly and be able to demonstrate that they took account of the individual's ability to repay.

Regarding the capacity of creditors to access the information necessary to conduct a creditworthiness assessment, as illustrated in Table 24, obstacles remain regarding access of foreign creditors to credit data. The CCD also includes provisions facilitating this access for loans of less than EUR 75 000. Article 9 of the Directive provides for a non-discriminatory access for foreign creditors to national credit registers. According to the above mentioned Commission services survey, 16 Member States (Austria, Belgium, Bulgaria, Cyprus, Denmark, Estonia, Finland, Germany[617], Hungary, Italy, Latvia, the Netherlands, Romania, Slovenia, Malta and Sweden) and Norway intend to apply that Article 9 to mortgage credit. 8 Member States (Czech Republic, Ireland, Lithuania, Luxembourg, Poland, Portugal, Spain and United Kingdom[618]) have in contrast reported having no intention to apply this article to mortgage credit. (However, according to the London Economics study[619] foreign creditors have already the same access as national creditors in Spain and United Kingdom.) Taking into account all this information, non-discriminatory access is not or will not be available for mortgage creditors in nine Member States (Greece, France, Slovakia, Czech Republic, Ireland, Lithuania, Luxembourg, Poland and Portugal).

The implementation of the CCD will thus assist in reducing to some extent the obstacles shown in the Table 24.

Table 24: Overview of access to credit databases

Member State	Non-discriminative access to credit registers
Austria	Physical presence is required. Registration and authorisation as a credit institution is required.
Belgium	Physical presence is required. Creditors from other EU Member States: If a credit institution in their home Member State, then must seek 'registration' with the national Belgian regulator. If a NCI in home Member State, then they must seek 'inscription'.
Bulgaria	Foreign creditors are required to be credit institutions in order to access – but not to lend. Further they must have a physical presence. Domestic creditors need not be credit institutions. There are plans to transpose Article 9(1) of the CCD 2008 on non-discriminatory access.
Cyprus	The regulators, policy makers and industry associations in Cyprus report that there is no creditworthiness database in Cyprus. This information differs from that presented in the recent report of the Expert Group on Mortgage Credit,(see European Commission 2009d), which reports that there is one private credit bureau in Cyprus. This private credit bureau provides private companies, which subscribe to the credit bureau, access to the public information registry on issuers of dishonoured cheques.
Czech Republic	We have been informed that 'in general', access to the registers requires registration in the Czech Republic. Such that foreign creditors do not generally have the same access as domestic creditors.
Germany	All mortgage providers must be credit institutions in Germany. Both domestic and foreign credit institutions have access under the same terms and conditions.
Denmark	Foreign providers do not have access on the same terms and conditions as domestic mortgage providers.
Estonia	There is one private register and access therefore depends on the requirements of this private company.
Greece	Foreign creditors must be credit institutions in Greece in order to provide mortgages and to also to access the credit database.
Spain	Foreign and domestic mortgage providers have the same access. We believe there is no requirement for physical presence.
Finland	Foreign and domestic mortgage providers have the same access. No requirement for a physical presence.

617 Beyond the scope of the CCD all consumer credits (mortgage and others) with an amount of at least EUR 200 are covered.

618 No legal requirement but private registers use an approach that is non-discriminatory and based on reciprocity of access.

619 See footnote 136.

France	All mortgage providers must be credit institutions in France, and therefore only credit institutions can access the database. Both domestic and foreign credit institutions have access under the same terms and conditions to the private credit register.
Hungary	Foreign creditors must have credit institution status and a physical presence to access the credit database. This is not the case for domestic creditors where NCI may also gain access.
Ireland	Foreign and domestic creditors do not have the same access currently. We believe that because the credit register is private, it depends on this private company as to who has access. Access to the database is not regulated by the Financial Regulator.
Italy	Foreign mortgage providers are required to be credit institutions in order to access the credit registers. Foreign NCIs, which can provide mortgages in Italy, cannot access the registers. Further foreign mortgage providers require a physical presence.
Lithuania	Foreign mortgage providers are required to be registered as credit institutions in Lithuania to gain access.
Luxembourg	No credit registers in Luxembourg.
Latvia	Foreign mortgage providers are required to be registered as credit institutions in Latvia to gain access. However, foreign NCIs can provide mortgages in Latvia.
Malta	No information provided. However, using information provided by the Expert Group on Credit Histories; there are private credit registers in Malta and therefore it is likely that access depends on the conditions set by these private organisations.
Netherlands	No information provided. However, using the information from the Expert Group on Credit Histories; the credit registers in the Netherlands are private and access therefore most likely depends on the conditions set by these private organisations.
Poland	Foreign mortgage providers must be credit institutions to provide mortgage credit in Poland. However, foreign credit institutions cannot access the credit registers.
Portugal	Mortgage providers in Portugal must be credit institutions. Foreign credit institutions, without a physical presence in Portugal, do not have access to the credit databases.
Romania	Foreign mortgage providers must be registered on the National Banks Special Register in order to gain access. This is also required of domestic providers.
Sweden	Foreign and domestic mortgage providers have the same access.
Slovenia	Only credit institutions registered in Slovenia can access the credit registers.
Slovakia	Mortgage providers must be credit institutions to provide mortgage credit. If the foreign institution is a credit institution and they have a physical presence in Slovakia then can access.
United Kingdom	All creditors have access irrespective of their type i.e. credit institution or NCI. Further, no physical presence in the United Kingdom is required.

Source: London Economics, November 2009.

4.2.2. Suitability assessments

4.2.2.1. EU level

The Markets in Financial Instruments Directive requires that investment firms, when providing investment services to clients, request the client to provide information that will enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client[620]. If the client wishes to buy a product that the investment firm deems not to be appropriate, the client must be warned. Similarly, the Insurance Mediation Directive stipulates that the intermediary shall specify the demands and needs of the customer, and give underlying reasons for any advice given to the customer on any given product. Similar requirements, however, does not exist at EU level for mortgage credit providers or credit intermediaries.

4.2.2.2. Member State level

National law in this regard differs between EU Member States.

[620] Directive 2004/39/EC, Article 19.

Regarding credit intermediaries, for instance, in Belgium, creditors are obliged to inform themselves of the consumer's situation and "to look, amongst the credit contracts they usually offer or for which they usually intervene, for the type and amount of credit best adapted, owing to the financial situation of the consumer at the time the contract is concluded (and to the aim of the credit)".[621] In Ireland, creditors must collect sufficient information from the consumer to enable them to provide a recommendation for a product or service appropriate to that consumer.[622] In the United Kingdom, the requirement to assess the suitability of the product for the borrower is only relevant where advice is given[623].

Regarding credit intermediaries, the requirement to assess the suitability of products to the personal circumstances of the consumer is embodied in the national law of six Member States (Austria (only applicable to mortgage credit intermediaries), Belgium, Hungary, Ireland, Malta and the Netherlands[624]).

At the same time, 15 Member States[625] have legal or self-regulatory obligations to warn consumers about risks and consequences of particular products, particular as regards the risks of default or the overindebtedness. This implies that some form of suitability assessment is carried out in these instances.

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621 Article 11 of the Belgian Act of 12.6.1991 concerning consumer credit.

622 See footnote 537.

623 See footnote 51.

624 See footnote 6.

625 The following 13 Member States have legal requirements: Bulgaria, Denmark, Ireland, Greece, France, Cyprus, Hungary, the Netherlands, Poland, Portugal, Romania, Sweden and the United Kingdom. The following two Member States have self-regulation: Germany and Estonia.

Table 25: Overview of requirements to warn consumers about the risks and consequences

Member State	Requirements
Austria	No requirement in regard to mortgages
Belgium	No legal requirement or industry recommendations
Bulgaria	Legal requirement
Cyprus	Legal requirement for creditors
Czech Republic	No legal requirement but it is expected that if the CCD is transposed to mortgage credit will introduce such legal requirements for creditors and credit intermediaries
Germany	Industry self-regulation in special circumstances (vulnerability) or upon borrower's request. From 2010, a legislative requirement
Denmark	Legislative requirement to provide information on consequences of obtaining a mortgage including the impact on consumers' economic situation but these are not specific risk warnings
Estonia	Regulator guideline (self-regulation)
Greece	Legal requirement
Spain	No legal requirement
Finland	No legal requirement
France	Established by case law
Hungary	Legislative requirement
Ireland	Legislative requirement in special circumstances (vulnerability) or upon borrower's request
Italy	No requirement
Lithuania	No requirement
Luxembourg	No requirement specifically in regard to mortgage provision
Latvia	No requirement
Malta	No information provided
Netherlands	Legal requirement
Poland	Legislative requirement
Portugal	Legal requirement
Romania	Legal requirement
Sweden	Legal requirement
Slovenia	No legal requirements specifically for mortgage provision
Slovakia	No legal requirement
United Kingdom	Legislative requirement

Source: London Economics Legal Baseline survey, November 2009.

4.3. Problem description

Recent experience has emphasised that there is room for improvement in the creditworthiness and suitability assessments of particular mortgage products for particular borrowers. Risky products have been sold to consumers without consideration of whether they have the appropriate profile in a number of countries[626]. As a result, the number of defaults and foreclosures has increased in a number of countries[627] and their social and economic consequences will be exacerbated by the current economic crisis. These consequences are unlikely to be contained within one Member State, but are likely to bring about problems to the financial stability of other Member States as well. Swedish banks suffering from defaults in the Baltic States are an example for how such spill-over effects are being transmitted[628].

[626] An example of this are self-certification loans in the United Kingdom.

[627] In particular, according to data provided to Commission services by Member States, the default rate has increased. See Annex 1 for more information.

[628] See for example *Latvia threatens foreign banks with huge losses*, The Guardian, 7.10. 2009.

4.3.1. Creditworthiness

4.3.1.1. No EU-wide obligation to conduct a careful of suitability and creditworthiness

As explained above not all Member States impose an obligation on creditors to conduct a credit worthiness assessment. As a consequence, there is the risk that borrowers are granted loans that they cannot repay, increasing thus the risk of overindebtedness, default and foreclosure. This regulatory failure is unfortunately reinforced by two other problems: a lack of proper incentives and/or creditors difficulties to gather the necessary information.

4.3.1.2. Incentives not right to conduct appropriate creditworthiness assessment

Although it is both in the interest of the creditor and the borrower to careful assess the repayment capacity of the latter, this is not always their priority. For the borrower, the reasons are explained by behavioural economics theory. Consumers' 'short-termism' will push them to make the choice of accessing today the home they dream of and leaving for later the careful consideration of possible consequences[629]. For the creditor, incentives to conduct a costly creditworthiness are lower in the case of mortgage credit than for consumer credit because of the collateral given as guarantee (i.e. the property bought with the loan). If, in addition, as has been the case in the last decade in a number of Member States such as Ireland or Spain, the real estate market is booming, the risk perceived by the creditor is lower since the collateral is expected to increase in value.

A creditor may also be less encouraged to perform a careful creditworthiness assessment when it can transfer the risk of default to third parties by issuing residential mortgage backed securities[630] or by selling the loan portfolio or simply because the creditor anticipates that the government will provide a bail out in case of massive defaults. As pointed out by recent research, a model that is particularly susceptible to moral hazard is the 'create and trade' model of securitisation where creditors shifted credit risk to capital investors.[631]

Competitive pressures within a sector may also contribute to diminishing underwriting standards. If a substantial part of firms in the market is short-term oriented and engaging into aggressive lending practices, it becomes increasingly difficult for a single firm to keep more prudent underwriting standards without losing market share.[632] Thus, creditors may have incentives not to undertake a thorough creditworthiness assessment to speed up the process and avoid losing consumers who are in a hurry to obtain a loan.

Anecdotal evidence[633] from before the financial crisis indicates that the business models of some creditors included lending decisions based entirely on underlying collateral without undertaking a proper assessment of consumer's ability to repay. Such strategies, sometimes referred to as 'equity lending' or 'predatory lending' (when there is no chance that the borrower will be able to repay the loan) are effectively supporting house price speculation which, in turn, may further fuel a boom in house prices.

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629 Studies such as *The economics of impatience*, Ernst Fehr, 2002, show how people are impatient when deciding between small benefits in the short-term against bigger benefits in a longer run.

630 Currently being addressed in the revision of the Capital Requirements Directive.

631 See footnote 136.

632 See footnote 136.

633 See for instance, remarks made at the Hearing on Responsible Lending and Borrowing.

4.3.1.3. Ability to access reliable appropriate information on the borrower

Another obstacle to a thorough creditworthiness assessment is the lack of appropriate information about the borrower. Creditors may obtain this information directly from the borrower but will often prefer to contrast it with credit information from other sources such as credit registers or the creditor's internal information on the person (e.g. based on the use of his/her current account, credit card…). Creditors feel that, in order to obtain a loan in the first place and obtain a better interest rate, consumers are tempted to overstate their financial situation. As recent research has pointed out, "there are indeed powerful borrower incentives to hide information from the creditor that could lead to loan rejection."[634] The incentive coming from housing needs may go as far for some borrowers that they may want to overstretch themselves in order to get into bigger and/or better quality dwellings. Evidence provided by the credit reference agency Experian suggests that consumers frequently overinflate their income and underestimate their commitments. Some estimates have found this to be significant in up to 70 % of mortgage applications.[635] Furthermore, the consultation on responsible lending indicated that some malpractice on the part of credit intermediaries assisting the borrower to obtain a loan[636]. Another reason to seek information from other sources than the borrower is that even if he/she is honest, many studies have proven that people tend to be overoptimistic and underestimate event risks (such as unemployment), thinking that that would not happen to them[637].

However, the information available from external sources may not be enough to assess the creditworthiness of the borrower for four main raisons. First, the creditor may not have access to the data. Secondly, the data may not be complete. Thirdly, the data may be incorrect or out-of-date. Finally, the data obtained from different sources may not be comparable and therefore cannot be exploited.

Restrictions to accessing data can stem from regulatory requirements (regulatory failure) or limitations originated at market level (market failure). Data access restrictions broadly fall into two categories: conditions relating to the membership/client criteria (often regulatory requirements) and those relating to the fee structure. Membership and/or client criteria include, for example, the need to undertake credit granting activity, holding a banking license, having a physical presence in the Member State, compliance with reciprocity agreements, and compliance with data protection laws. Charges for accessing credit data vary with one-off joining fees, ongoing membership fees and per transaction fees for consultations evident across Europe. Joining fees can range from EUR 0 for public and some private credit registers to in excess of EUR 1 000 for some private credit registers – as much as EUR 75 000 in one instance. Transaction fees range from EUR 0 to around EUR 2[638]. The cost of consultation may however vary according to usage (volume-based pricing): one private credit register has

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634 See footnote 136.

635 *Response to the Financial Services Authority Mortgage Market Review Discussion Paper*, Experian, December 2009.

636 *Feedback Summary of Consultation on Responsible Lending and Borrowing*, European Commission, December 2009: Call Credit a credit register and Genworth Financial a financial services provider mentioned a problem specifically attributed to credit intermediaries: intermediaries in some Member States encouraged borrowers to falsify income information on their credit application, particularly for 'self-certification' mortgages, but also for other credit. Some respondents referred to the fact that evidence of poor behaviour could be seen in the sanctions imposed on credit intermediaries by regulators and the courts in response to mis-selling.

637 *Illusion and well-being: a social psychological perspective on mental health*, Brown and Taylor, 1988.

638 *Report on the retail banking sector inquiry*, SEC(2007) 106, European Commission, 31.1.2007.

reported that its average transaction fee varied from EUR 0.46 to EUR 10.95 depending on use.[639]

Concerning the completeness of the information, the data available in credit registers may not contain all the information that it should. In the case of some private credit registers, reporting is voluntary. According to research by the Commission, some private credit registers may accommodate larger banks by waiving the requirement of full disclosure of data.[640] The enforcement of the principle of reciprocal data sharing could also be problematic in these cases. Where full disclosure is a legal obligation (in case of public and certain private credit registers) incomplete reporting by creditors should not arise. However, even then, reporting entities may not report everything that they are agreed or obliged to. According to research by the Commission[641], in a small number of Member States, problems arise in relation to compliance with national data sharing rules. For example, there are reports of instances where credit registers do not exercise close scrutiny of the information provided by their members or the members fail to provide complete information on their clients.[642]

The information stored about a consumer in a credit register may be also incorrect or outdated. A study on credit scoring in Germany[643] has found evidence for a high percentage (45 %) of inaccurate and incomplete credit reports.

Finally, the difficulty to use data that is not comparable is a real problem, particularly in a cross-border context. Credit registers in different countries may not contain the same data. For example, reporting thresholds vary considerably between credit registers, e.g. ranging from EUR 35 to EUR 1 500 000.[644] This means that debts that are registered in one country will not be in another because their amount is considered too small. Divergences may also emerge because the definitions used by credit registers for certain terms, such as payment defaults and delinquencies, are different (e.g. payment 30 days overdue vs 90 days)[645]. Thus, a consumer classified as in default in one Member State may not necessarily be classified – under the same circumstances – as in default in another Member State. A further source of differences stems from the fact that some credit registers collect only negative data whereas others collect both positive and negative data[646].

The difficulties in accessing credit data, understanding and using the data led the Commission to the establishment of an Expert Group on Credit Histories (EGCH). The EGCH has pointed out that inaccurate credit risk assessment may lead to wrong credit granting decisions which may have, in turn, adverse effects on competition and the wider economy. Creditors that overestimate a borrower's credit risk and turn down the credit request or charge a higher interest rate may be at an inferior competitive position compared to creditors that assess the credit risk more accurately. Creditors that underestimate credit risk may face unexpected losses. The absence of sufficient and accurate information, both at the point of acquisition and

[639] See footnote 638.
[640] See footnote 638.
[641] See footnote 638.
[642] See footnote 638.
[643] *Verbraucherinformation Scoring*, Report for the Bundesministerium für Ernährung, Landwirtschaft und Verbraucherschutz, Korczak and Wilken, 2009, http://www.bmelv.de/cae/servlet/contentblob/638114/publicationFile/36111/Scoring.pdf.
[644] *Report on the Expert Group on Credit Histories*, European Commission, May 2009, see footnote 184.
[645] See footnote 644.
[646] Negative data generally consist of statements about defaults or arrears. Positive data covers facts of contractually compliant behaviour. It generally consists of assets and liabilities as well as guarantees.

subsequent account management, may also deter (foreign) market entrants. In addition, incomplete information may lead to a situation where borrowers find themselves having to pay an unnecessary high interest rate, exposed to the risk of over-indebtedness or simply having their credit application turned down and facing difficulties to get access to the credit market.[647]

4.3.2. Suitability

From a consumer's perspective, mortgage credit products are complex and their features hard to understand. Mortgage credit, on the other hand, represents one of the biggest and longest financial commitments a borrower is likely to face in his lifetime. An indication for the magnitude of borrower's vulnerability to payment shocks can be derived from surveys that found 12 % of the European citizens spent 40 % or more of their disposable income on housing.[648] At the same time, there has been an explosion in credit market product innovation in recent years, with risky products such as mortgages denominated in foreign currency, subprime, interest-only and self-certification mortgages taking a significant market share in some Member States.[649] It is therefore of crucial importance that the credit product a borrower is taking out is suitable for their needs and circumstances.

4.3.2.1. Incentives not right to conduct appropriate suitability assessment

Conflicts of interest may influence the decision on whether a product proposed by creditors and credit intermediaries is suitable for a particular consumer.

A misalignment of incentives may occur since suitability assessments are costly. Costs incurred in relation to the suitability assessment include, among others, employee's time spent and appropriate systems. A creditor or intermediary may attempt to minimise these costs.

Another conflict of interest undermining the suitability assessment may arise due to remuneration structures. Credit intermediaries or bank employees may not perform a thorough suitability assessment and thus provide unsuitable loans to borrowers, for example simply because they receive higher commissions for such loans. This situation has repeatedly being criticised by financial sector trade unions. They argue that the pressure employees receive to fulfil selling targets is a "key obstacle to qualified and objective advice and to obtaining the best coherence between the products sold and the need and risk profile of the individual customer"[650].

There may also be an incentive to be negligent regarding the suitability assessment in cases where the agent does not bear the risk (e.g. the credit intermediary). Also the creditor may be discouraged to invest resources on a suitability assessment since, in the event of a borrower's default, the creditor can always avail to the property which is held as collateral. As such, consumers might be encouraged to take out a mortgage loan at their current maximum financial ability in terms of repayments. In this case, consumers run a serious risk of losing

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647 See footnote 644.

648 EU-SILC, 2005, 2007.

649 See footnote 136 for specific examples.

650 Contribution of Uni Europa Finance to the consultation on tying practices (http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/tying/citizens_others/unieuropa_enpdf/_EN_1.0_&a=d). Similar arguments can be found in Uni Europa Finance contribution to the consultation on responsible lending and borrowing.

their home in the event of even small changes to their financial situation or small increase in interest rates if they have taken out a variable interest rate loan. This asymmetric relationship means that the interests of a creditor and borrower are skewed.

Another case were the suitability assessment may be carried out less carefully are the cases where the consumer is eager to obtain a mortgage loan quickly, the originator may seek to provide an offer as soon as possible in order to prevent the customer from looking elsewhere.

4.3.2.2. Ability to access reliable appropriate information on the borrower

Another problem in respect of the suitability assessment arises if creditors and credit intermediaries are unable to perform a careful assessment due to a lack of appropriate information on the needs and preferences of the borrower. In contrast to the case of creditworthiness assessments, the main source of information on aspects necessary to conduct a suitability assessment is the borrower him/herself. However, as explained before, borrowers have an incentive to present the information on them in a way as to obtain the loan.

4.3.3. Consequences

In the absence of an obligation to perform creditworthiness and suitability assessments ahead of the granting a credit, the underwriting conditions have been relaxed in a number of Member States and borrowers have end up with products not adapted to their needs. Products such as self-certification mortgage loans, subprime, interest only or loans with loan-to-value rations of 100 % or above have become a common credit product in some countries. Some of those market segments, such as the market for self-certified mortgages, have experienced comparatively higher default rates.[651]

The absence of a framework for creditworthiness and/or suitability assessments may also undermine consumer confidence on the objectiveness of the advice or the honesty of the offer he/she receives from the creditor or the credit intermediary. Lower levels of consumer confidence may have a negative impact on the demand for credit and on the consumer mobility (particularly across borders).

In addition, even if an assessment has been conducted, the difficulties in accessing the necessary information, in order to assess the borrower's capacity to repay or the adequacy of the credit to his/her needs and circumstances, may render its results unreliable. Concerning suitability, an inadequate assessment may result in consumers ending up with products that are unsuitable for them and that will unnecessarily increase their level of indebtedness. They have therefore a higher risk of defaulting or having their home repossessed.

In the case of a creditworthiness assessment, the lack of information has important consequences for both the borrower and the creditor. In the case of the borrower, there are three possible consequences: a) higher risk of default (and therefore the risk of loosing his/her home higher), b) access to credit restricted (since the creditor does not have enough evidence showing that the borrower will repay) or c) credit granted but the applicable interest rate will be higher (the creditor will add a 'risk premium' to compensate for the uncertainty about the borrower capacity to repay). A 2008 survey by the ECB[652] showed that banks imposed stricter

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651 See footnote 136.
652 *The Euro area bank lending survey*, European Central Bank, January 2008, http://www.ecb.int/stats/pdf/blssurvey_200801.pdf?cd42a1f79a509b82a015183f84f2ee1e.

conditions to borrowers as a result of the crisis. For the creditor, the main risk of not been able to assess the borrower's creditworthiness is the risk of default and the losses attached to it (particularly if the value of the mortgaged property). In a Commission survey[653], creditors in some Member States reported for the first quarter of 2009 non-performing credits for house purchases of up to 7.7 % (see Annex 1). The risk of not been able to recover costs with the foreclosure of the property has importantly increased during the last years in those countries where real estate sector prices have started to decline (such as in Ireland or Spain but also in the Baltic States).

In the worst case scenario, high default rates in the mortgage portfolio may bring about the failure of the creditor with potentially severe consequences for the financial system and the wider EU economy. The numerous Governments and Central Banks' interventions during these last years to 'save' a number of financial services entities proves that this is not a small risk.

4.4. Summary of problems and consequences

Table 26: Problems and consequences

Problems	Consequences
Regulatory failures Creditworthiness and suitability Inadequate assessment of suitability and creditworthiness Creditworthiness Barriers to accessing reliable appropriate information on the borrower (creditor) **Market failures** Creditworthiness and suitability Incentives not right to conduct appropriate assessment Incentives for the borrowers not to disclose all relevant information Ability to access reliable appropriate information on the borrower	**Risk of consumer detriment & reduced customer mobility** – consumers obtain a credit that they cannot afford or which is not suitable to their need and circumstances => reduced consumer confidence => risk of consumer overindebtedness => risk of default and, in the worst case scenario foreclosure on home Creditors cannot access the necessary information to conduct the creditworthiness assessment => credit offer is restricted or interest rate higher for the consumer => consumers cross-border mobility is restricted **Low cross-border activity & missed business opportunities** – creditors and credit intermediaries (for suitability) cannot access the necessary information to conduct the assessment. => cross-border mobility is restricted => competitive disadvantage for creditors with less information on the borrower => risk of loan default, losses if foreclosure does not cover costs and, in the worst case scenario, risk of financial stability for the whole economy

4.5. Stakeholder views

4.5.1. Consumers

In their responses to the 2009 public consultation on responsible lending and borrowing, consumer advocates considered that creditworthiness assessment is the basis for responsible lending. A number of consumer representatives supported annual random quality audits by regulatory bodies to inspect creditors' assessments of affordability or suitability of products for borrowers. In addition, consumer representatives expressed the view that the assessment should be based on information from credit registers and from the borrower, supported by the necessary documentary proof. However, as also stressed during the discussions leading to the

653 *Retail Banking Survey*, DG Economy and Financial Affairs, July 2009.

adoption of the EGCH recommendations, consumers are generally concerned about data protection and privacy, and would prefer a greater emphasis on the manual analysis of the credit data rather than an over-reliance on automated scoring.

4.5.2. Financial services industry

Responding to the consultation on responsible lending, financial services industry responses also indicated that creditworthiness should always be assessed. However, they were against the establishment of mandatory criteria or tools for the assessment of creditworthiness such as loan-to-value ratios or ratios on the monthly disposable income. They stated that creditors should have freedom to select these and/or other criteria or tools if competition is to be preserved in the banking business. Financial services industry respondents were of the view that suitability assessments should not be harmonised, owing to the very different legal and fiscal context across the Member States. Creditors should also be able to have their own procedures, which should be open to inspection to ensure they do not introduce consumer detriment.

As regards to access to databases, creditors participating to the EGCH supported the group recommendation to extend to mortgage credit the CCD provision regarding the non-discriminatory access for foreign creditors to national databases. Moreover, the EGCH has recommended that some convergence should be achieved in respect of content of databases (i.e. definitions used, data retention periods), interpretation of data protection rules, as well as, consumer access conditions.

4.5.3. Credit registers

As for the creditors participating to the EGCH, credit registers supported the group recommendation to extend to mortgage credit the CCD provision regarding the non-discriminatory access for foreign creditors to national databases. However, it should be left to the credit registers and their users (creditors) to define the access model most adapted to their needs.

4.5.4. Member States

Member State authorities stated in their responses to the responsible lending consultation that creditworthiness assessments should always be performed by the creditor. They considered that in cases of transactions involving credit intermediaries, whether tied (agents) or untied (brokers), the creditor should also be regarded as responsible for the creditworthiness assessment. With regard to suitability, Member State authorities considered that the borrower, rather than the creditor, should take on the responsibility for assessing if a product is suitable for his/her personal circumstances. Only if a credit intermediary happens to act on behalf of a prospective borrower, should he undertake a suitability assessment.

Concerning access to databases, public authorities participating to the EGCH emphasised the importance of respecting the Data Protection Directive provisions in order not to undermine consumer protection.

4.6. Objectives

4.6.1. General objectives

– To create an efficient and competitive Single Market for consumers, creditors and credit intermediaries with a high level of consumer protection by fostering:

  – consumer confidence;

  – customer mobility;

  – cross-border activity of creditors and credit intermediaries;

  – a level playing field.

Promote financial stability throughout the EU by ensuring that mortgage credit markets operate in a responsible manner.

4.6.2. Specific objectives

– Ensure that creditors and borrowers take appropriate lending and borrowing decisions.

4.6.3. Operational objectives

– Ensure that conflicts of interest do not influence lending and borrowing decisions.

– Ensure access to appropriate information to assess creditworthiness and suitability.

– Ensure that creditors adequately assess consumers' creditworthiness.

– Ensure that creditors and/or credit intermediaries adequately assess the suitability of the credit to consumers' needs and circumstances.

4.7. Description of policy options

4.7.1. Creditworthiness assessment

4.7.1.1. Option 1.1: Do nothing

Doing nothing would mean that all the problems identified above remain.

4.7.1.2. Option 1.2: Requirement for the creditor to assess the borrower's creditworthiness

This option would translate in a requirement, as in Article 8 of the CCD, for Member States to ensure that, before the conclusion for the credit agreement, the creditor assesses the ability to repay of the consumer.

Given the large array of mortgage credit products, business strategies and underwriting standards within the internal market, prescribing, at this stage, how that assessment should be done could have negative impacts on the volumes lent and increase the costs faced by creditors for little additional (social) benefit. Implementing measures could be however considered in the event a legislative instrument is chosen to clarify, at a latter stage, the elements to be taken into account when assessing the borrower's creditworthiness.

4.7.1.3. Option 1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment

This option would mean that the creditor conducts a creditworthiness assessment, and if there are reasonable doubts on the borrower's capacity to fulfil the loan repayment obligations, the creditor must not grant the credit.

Given the large array of mortgage credit products, business strategies and underwriting standards within the internal market, prescribing, at this stage, how that assessment should be done could have negative impacts on the volumes lent and increase the costs faced by creditors for little additional (social) benefit. Implementing measures could be however considered in the event a legislative instrument is chosen to clarify, at a latter stage, the elements to be taken into account when assessing the borrower's creditworthiness.

4.7.1.4. Option 1.4: Non-discriminatory access to databases for creditors

This option would imply that all creditors have access to databases under the same conditions.

4.7.1.5. Option 1.5: Homogenise the content and characteristics of databases

This option would lead to a harmonisation of the data contained in databases (type, definitions…) but also of other databases' features, such as registration thresholds, how often the information is updated or for how long it is stored. Implementing measures, in the event a legislative instrument is chosen, could be used to promote convergence in definitions.

4.7.1.6. Option 1.6: Requirement for the borrower to provide correct information on his/her situation

This option would imply introducing a requirement for the borrower to disclose all relevant information requested by the creditor. Sanctions could be envisaged if incorrect information is provided.

4.7.2. Suitability assessment

4.7.2.1. Option 2.1: Do nothing

Doing nothing would mean that all the problems identified above remain.

4.7.2.2. Option 2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered

This option would imply introducing a requirement for Member States to ensure that, before the conclusion for the credit agreement, the creditor or credit intermediary assesses whether the product is appropriate given the borrower's needs and circumstances.

Given the large array of mortgage credit products and business strategies within the internal market, prescribing, at this stage, how that assessment should be done could have negative impacts on the volumes lent and increase the costs faced by creditors for little additional (social) benefit. Implementing measures could be however considered in the event a legislative instrument is chosen to clarify, at a latter stage, the elements to be taken into account when assessing the suitability of the product for the borrower.

4.7.2.3. Option 2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her

As stressed by some respondents during the responsible lending consultation the borrower is the best placed to know whether a credit product is suitable to him/her. However, it is also true that the borrower may lack the necessary financial capability to take that decision on his/her own. This policy option would impose the need for the creditor or credit intermediary to conduct a suitability assessment and to warn the borrower by clearly drawing his/her attention to the fact that according to the suitability assessment the credit product does not seem to be the appropriate one for the borrower. This option is consistent with similar obligations already existing in EU law (e.g. Article 19.5 of the MIFID).

Given the large array of mortgage credit products and business strategies within the internal market, prescribing, at this stage, how that assessment should be done could have negative impacts on the volumes lent and increase the costs faced by creditors for little additional (social) benefit. Implementing measures could be however considered in the event a legislative instrument is chosen to clarify, at a latter stage, the elements to be taken into account when assessing the suitability of the product for the borrower.

4.7.2.4. Option 2.4: Requirement for the borrower to provide correct information on his/her situation

This option would imply introducing a requirement for the borrower to disclose all relevant information requested by the creditor. This option will be analysed only once (within the creditworthiness analysis of options). Similar conclusions may be expected if analysed in relation to suitability assessments.

4.7.2.5. Option 2.5: Specific product regulation including bans or caps on certain credit products

Under this option specific product regulation could prescribe thresholds for LTV, LTI, define caps for interest rate variations or ban certain products or product features (e.g. self-certification loans, mortgages in foreign currency or 'teaser rates').

4.8. Description of options for policy instruments

Each of the above options could be given effect through a variety of different policy instruments. These include an industry self-regulation (Code of Conduct), Community level non-binding measures such as a Recommendation or Communication, or binding Community measures such as Community legislation in the form of a Regulation or Directive. Table 27 explores the feasibility of giving effect to each of our policy options through each of the available policy instruments.

Table 27: Creditworthiness and suitability – Policy options versus instrument

Policy options: content vs instrument	Self-regulation	Recommendation	Communication	Directive	Regulation
Creditworthiness assessment					
1.1: Do nothing					
1.2: Requirement for the creditor to assess the borrowers' creditworthiness	X	X		X	X
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	X	X		X	X
1.4: Non-discriminatory access to databases for creditors	X	X		X	X
1.5: Homogenise the content and characteristics of databases		X		X	X
1.6: Requirement for the borrower to provide correct information on his/her situation	X	X		X	X
Suitability assessment					
2.1: Do nothing	X	X		X	X
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered	X	X		X	X
2.3: Requirement to warn the borrower if the chosen credit product is not suitable	X	X		X	X
2.4: Requirement for the borrower to provide correct information on his/her situation	X	X		X	X
2.5: Specific product regulation including bans or caps on certain credit products	X	X		X	X

A Commission Communication would also be unable to achieve any of the objectives as it is a tool to communicate information to the Member States rather than effect a particular change in the way things are done. The following sections will assess the impact of the policy options and will describe which policy instrument is the most appropriate to use, as well as the underlying reasons for the choice.

4.9. Assessment of policy options

4.9.1. Creditworthiness assessment

4.9.1.1. Option 1.1: Do nothing

Effectiveness of policy option

Most of the operational objectives will not be achieved if the status quo is maintained. Conflicts of interest risk will continue to influence lending and borrowing decisions and, except in those Member States where specific provisions already exist, the creditworthiness of the borrower may not be properly assessed. Some improvements can however be expected regarding the access to information and adequate creditworthiness assessments. As explained above, 16 Member States[654] have extended (or plan to do so) CCD provisions on non-discriminatory access to databases to mortgage credit and 17 Member States[655] have extended (or plant to do so) CCD provisions on creditworthiness. This should translate in an easier access for creditors to databases and a more generalised obligation across the EU to assess the creditworthiness of the borrower.

Despite this, regulatory gaps and many of the failures described in the problem section above will remain. As a result, the specific objective of ensuring that creditors and borrowers take appropriate lending and borrowing decisions will not be fulfilled across the EU. For example, issues such as the correctness of the data obtained from the borrower or databases will not be addressed. Neither would the problem of lack of incentives for creditors to perform proper creditworthiness checks be mitigated. As explained above, while a defaulting borrower is not in the interest of creditors, creditors have an incentive to reduce their underwriting standards in order to increase market shares and/or short-term profits. Competitive pressures in the sector may aggravate this problem. Prudent business policies may not be sustainable in a market where most players are short-term oriented and aggressively expanding mortgage lending.[656] Especially during times of a benign macroeconomic environment with high market confidence and rising house prices, creditors may trust more rising values of the property that is charged against as security for the mortgage.

It could be argued that, as reported by the ECB in its January 2008 bank lending survey[657], creditors move back to stricter underwriting standards in difficult times. However, this does not mean that lessons will be drawn and responsible standards will be maintained. Later ECB surveys show a loosening of credit conditions. A more concrete example can be found in Spain. The press has recently criticised that Spanish banks have resumed granting mortgage loans representing 100 % of the value of the property. This would seem to be the only way for Spanish banks to get rid of the important amount of properties now in their portfolios (due to the increase of foreclosures since the burst of the real estate bubble)[658].

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654 Belgium, Bulgaria, Denmark, Germany, Estonia, Italy, Cyprus, Latvia, Hungary, Malta, the Netherlands, Austria, Romania, Slovenia, Finland and Sweden.

655 Belgium, Bulgaria, Denmark, Germany, Estonia, Italy, Cyprus, Latvia, Hungary, Malta, the Netherlands, Austria, Romania, Slovenia, Slovakia, Finland and Sweden.

656 See footnote 136.

657 See the latest surveys at http://www.ecb.int/stats/money/surveys/lend/html/index.en.html.

658 *Home loans get easier for Spaniards*, Wall Street Journal, 21.6.2010.

Nor would the identified general objectives will be tackled. Different national approaches regarding creditworthiness and suitability assessments will increase the costs for players wishing to offer their services cross-border. Maintaining a patchwork of legal and regulatory frameworks will not address either the objective to achieve a levelled playing field. It would also discourage both consumers' and industry's mobility. Doubts about the reasons why a particular credit product is offered to the borrower will not disappear and this could undermine consumer confidence. Finally, financial stability will remain at risk, particularly in periods of economic gloom.

Impacts of policy option on stakeholders and efficiency

In the absence of action, many of the regulatory and market failures identified would remain unaddressed. In those countries where no legal provisions on the need to assess the borrower's creditworthiness exist, there is a risk that creditors adapt their underwriting conditions in line with factors other than the repayment capacity of the client. A positive economic environment, a growing real estate sector or competitive pressures may therefore have an important influence on their lending decisions. While 'doing nothing' will probably allow creditors to maximise benefits in the short run, in the long run, creditors, borrowers, and the whole economy risk being penalised. Default rates will continue to evolve abruptly, leaving behind them in the worst periods, important creditors' losses, a growing number of borrowers losing their home and shaky financial stability.

For Member States, no major impacts can be expected. However, if markets doubt the financial stability of financial services entities, there may be a need to 'save' them with taxpayers' money. The Table 28 provides an overview of some Member States budgetary effort to limit the consequences of the financial crisis.

Table 28: Support for financial and other sectors and upfront financing need
(as of August 2009; in percent of 2008 GDP; average using PPP GDP weights)

	Capital injection	Purchase of assets and lending by Treasury	Guarantees	Liquidity provision and other support by Central Bank	Upfront Government financing
Austria	5.3	0.0	30.1	…	8.9
Belgium	4.8	0.0	26.4	…	4.8
France	1.4	1.3	16.4	…	1.6
Germany	3.8	0.4	18.0	…	3.7
Greece	2.1	3.3	6.2	…	5.4
Ireland	5.9	0.0	198.1	…	5.9
Italy	0.6	0.0	0.0	…	0.6
Netherlands	3.4	11.2	33.6	…	14.6
Portugal	2.4	0.0	12.0	...	2.4
Spain	0.8	3.9	15.8	...	4.6
Sweden	1.6	4.8	47.5	13.9	5.2
United Kingdom	3.9	13.8	53.2	19.0	20.0
European Central Bank	...	...	...	8.5	...

Source: IMF, November 2009[659]

4.9.1.2. Option 1.2: Requirement for the creditor to assess the borrower's creditworthiness

Effectiveness of policy option

An obligation to assess consumer's creditworthiness would address all the general objectives identified above. It will establish a level playing field among creditors from different Member States and therefore encourage their mobility. It will also underpin consumers' confidence in the lending sector and thus would foster their mobility. The economy as a whole would also benefit, since financial stability will be reinforced.

The specific objective of taking the appropriate decisions will be achieved as long as enough information is available to assess the creditworthiness of the borrower. This option will also contribute to fulfilling the operational objective to ensure that creditors adequately assess the consumer creditworthiness and to mitigate conflicts of interest.

Impacts of policy option on stakeholders and efficiency

As explained above, 17 Member States[660] are already applying or planning to apply Article 8 of the CCD (Obligation to assess the creditworthiness of the consumer) to mortgage credit. In addition, six Member States[661] already have similar provisions in place. Accordingly, there will not be incremental costs incurred by those 23 Member States[662] for implementing the obligation to carry out a creditworthiness assessment. Member States and their respective regulators will also need to implement, supervise and enforce the new requirements.

659 Information extracted from Annex table 3 in *The State of Public Finances Cross-Country Fiscal Monitor*, IMF staff position note, November 2009.

660 See footnote 655.

661 Czech Republic, Ireland, Greece, Lithuania, Poland and the United Kingdom.

662 Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Ireland, Greece, Italy, Cyprus, Latvia, Lithuania, Hungary, Malta, the Netherlands, Austria, Poland, Romania, Slovenia, Slovakia, Finland, Sweden and the United Kingdom.

Commission services estimate the incremental costs for the four Member States[663] who currently do not have rules in place at EUR 0.09 million in one-off costs and EUR 0.1–0.3 million in annual recurring costs. A recent external study estimated net costs of EUR 10.53 million (net present value of costs – benefits) for the governments and regulators across the EU over 15 years (2009–2014).[664]

On the one hand, consumers and society at large are likely to benefit from the creditworthiness checks since the probability of default will be reduced. This effect is quantified to amount to approximately EUR 124–187 million for the EU27. On the other hand, requiring creditworthiness checks may also have a negative impact on consumers since there is a risk that access to credit for some groups of consumers (e.g. low income) is restricted. Those errors are usually maximised in a pro-cyclical manner after some defaults have occurred (credit crunch).[665] However, this will only be the case in those four Member States[666] that are currently not already applying an obligation to assess creditworthiness. Costs with regard to reduced access to credit will differ country by country and location by location. In the United Kingdom, a study has recently been published on the impact of Financial Services Authority (FSA) proposals to introduce a requirement to assess affordability.[667] This research estimates the impact of affordability requirements on access to credit. The research states that "around 10 % of existing mortgages would not pass the new tests" and that "the expected reduction in sales for the different categories of people was estimated as follows: self-employed (38 %), income not from employment (32 %), poor credit rating (55 %), low incomes (48 %), 90 % LTV or higher (60 %), for combined business and residential property (36 %), mortgage renewal (20 %), first time buyers (24 %), likely to get into arrears (52 %)."[668] In general, larger lenders forecast a smaller reduction in mortgage sales than smaller lenders.[669] It should be underlined that these conclusions should be taken only as an indication of the possible impact on access to credit as several of the product lines mentioned are more prevalent on the UK market than on other EU mortgage markets. Consequently, the impact on access to credit is likely to be less significant elsewhere in the EU. It needs also to be highlighted that FSA proposals go much further in terms of detail (i.e. elements to be taken into account for the assessments) than the proposed policy option to assess creditworthiness. They are therefore expected to have a stronger impact than Option 1.2. Finally, regarding consumers' access to credit, it should be noted that reduced access can be both due to less irresponsible lending or reduced lending to certain groups regardless of their individual creditworthiness. In the latter case, it can be considered as a cost but in the former it would not since it would be one of the reasons why defaults decrease.

Those creditors that will need to introduce creditworthiness assessment procedures should gain in market share and earn higher profits as the requirement to perform a creditworthiness assessment will reduce credit risk mispricing by short-term oriented creditors. Moreover, a direct requirement imposed on creditors to conduct a proper credit assessment is also likely to limit the ability of short-term oriented creditors to defraud investors by transferring excess credit risk (in excess of what is priced to them). Incremental implementation costs of the

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663 Spain, France, Luxembourg and Portugal.

664 See footnote 136.

665 See footnote 136.

666 See footnote 663.

667 *Assessment of compliance costs and indirect costs as a result of the MMR lending reforms*, Oxera, 7.7.2010, http://www.fsa.gov.uk/pubs/policy/oxera_mmr1016.pdf.

668 See footnote 667.

669 See footnote 667.

policy option for creditors will vary as well. As mentioned previously, only four Member States[670] will need to introduce compulsory creditworthiness checks for mortgage credit. But even in those Member States, a majority of creditors does already perform creditworthiness checks as it is in their prudential self-interest or required by general banking law.[671] Creditors that already carry out creditworthiness checks will potentially need to adjust their processes to the new requirements. It can be expected that the incremental one-off costs to the industry of obligatory creditworthiness assessments for mortgage credit total EUR 104 million. For those firms currently not performing creditworthiness checks, there would also be annual recurring costs that are estimated to amount to EUR 11 million per year.

<u>Quantification of costs and benefits</u>

Consumers and society in general will face aggregate benefits of EUR 124–187 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 10–15 basis points due to more thorough assessments of creditworthiness being undertaken.

– This is equivalent to mortgages of EUR 124–187 million[672].

– This figure is based on the assumption that 90 % of lenders already conduct creditworthiness assessments, even in those Member States where there is currently no obligation to do so.[673]

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[674].

Consumers will also benefit from the increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors will face one-off costs of EUR 104 million and annual recurring costs of EUR 11 million. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 104 million. This is based on the assumption that each credit institution must provide 8 hours training to 20 % of its staff. It is also based on the assumption that each credit institution requires 300 man days to create, prepare, and configure new IT systems and Standard Operating Procedures.

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[670] See footnote 663.
[671] See footnote 136.
[672] See footnote 277.
[673] "Across the industry, the proportion of institutions that do not use affordability methods or models is estimated to be around 12 %". See footnote 667.
[674] See footnote 268.

– Incremental annual recurring costs are estimated at EUR 11 million. This is based on the assumption are based on the assumption that undertaking a thorough creditworthiness check takes 0.5 hours per mortgage contract. It is also assumed that ensuring compliance takes about 0.5 hours and that 10 % of mortgage contracts are checked.

– This figure is based on the assumption that 90 % of lenders already conduct creditworthiness assessments, even in those Member States where there is currently no obligation to do so[675].

– In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[676].

According to Commission services' estimates Member States will face EUR 0.09 million in one-off costs and EUR 0.2–0.3 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.09 million. This is based on the assumption in a recent study[677] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, four Member States[678] would have to introduce a creditworthiness requirement.

– Annual recurring costs of EUR 0.2–0.3 million. These based on the assumption that the administrations incur costs equivalent to 1–3 man hours per institution.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

The EUR 10.53 million is quoted in an external cost benefit analysis[679] is based on the following assumptions.

– The figure is a NPV of regulator costs over a 15-year period from 2009 to 2014.

– The one-off and annual recurring costs are based on the results of a questionnaire to regulators. As relatively few quantitative responses were received, the highest figures received are applied to all countries to generate an upper bound of the likely cost. For this policy option, one-off costs are estimated at EUR 23 529 and annual recurring costs are estimated at EUR 30 000. Annual cost estimates were discounted using a real interest rate of 4 %.

– The difference between the results of the external cost benefit analysis and that of Commission services most likely reflect the fact that the study assumed that only

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675 See footnote 673.
676 See footnote 268.
677 See footnote 136.
678 See footnote 663.
679 See footnote 136.

eight Member States rules in place and thus close to the policy option and ten Member States were a medium distance from the policy frontier.[680]

4.9.1.3. Option 1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment

Effectiveness of policy option

Since this option implies the need to assess the creditworthiness of the borrower ahead of taking the decision to grant or not the loan, its effectiveness is very much the same as in the case of the previous policy option. It can be however expected that this option will go further in fulfilling most of the objectives, in particular the specific objective of ensuring that creditors take appropriate lending decisions.

Impacts of policy option on stakeholders and efficiency

On the one hand, consumers and society at large are likely to benefit from the creditworthiness checks and a subsequent denial of credit in the event of a negative outcome since the probability of default will be reduced. This impact will be larger than the impact under the previous policy option since not only will a creditworthiness assessment be made but if the results are negative, credit will not be provided, reducing the probability of overindebtedness and default as well as possible foreclosure. This effect is quantified to amount to approximately EUR 187–249 million for the EU27. On the other hand, requiring creditworthiness checks may also have a negative impact on consumers since there is a risk that access to credit for some groups of consumers (e.g. low income) is restricted. This risk will equally be larger than under the previous policy option. If the creditor has difficulties in obtaining appropriate information on the borrower, the number of excluded consumers risks being larger than necessary for responsible lending reasons. This risk is however difficult to quantify. Despite these divergent impacts, it is worth mentioning that a recent external study on the costs and benefits of certain policy options has carried out an in-depth scenario-based analysis of the effects of possible policy options on responsible lending on stakeholders and has found that creditworthiness checks resulting in 'credit denial' is the most effective option to increase society welfare in the presence of strong interest rate and house price cycles.[681]

For creditors, the impact of this policy option is also expected to be both positive and negative. Positive in the sense that the risk of losses linked to defaulting loans will be reduced. However, creditors may also lose market share and profits in the short run. The incremental costs of actual denying credit in the event of a negative creditworthiness assessment would be negligible. The costs rather arise from the need to conduct the creditworthiness assessment itself. Under this scenario, the majority of creditors would not need to make any changes. However, those who do not currently conduct a creditworthiness assessment will potentially need to adjust their processes to the new requirements. It can be expected that the incremental one-off costs to the industry of requirements to conduct a creditworthiness assessment and deny mortgage credit in the event of a negative outcome for mortgage credit total EUR 104 million. For those firms currently not performing

680 See footnote 136.

681 See footnote 136. It is an illustrative quantitative analysis considering one anonymous country case dominated pre-reform by uncapped adjustable-rate mortgage that illustrates any EU27 market dominated by products conveying significant payment shock risk. Traditional examples for countries in which adjustable-rate mortgages prevail are Ireland, Spain, Portugal and the United Kingdom.

creditworthiness checks, there would be annual recurring costs that are estimated to amount to EUR 11 million per year.

For Member States similar impacts to the ones explained for the previous option. Nine Member States (Cyprus, Czech Republic, France[682], Germany, Estonia, the Netherlands, Poland, Sweden and the United Kingdom) have a legal requirement in place to refrain from lending in the event of a negative creditworthiness assessment.[683] Five Member States (Belgium, Germany, Hungary, Latvia and Slovakia) have self-regulatory codes or practices in place.[684] Commission services estimate the one-off and annual recurring costs at EUR 0.4 million and EUR 0.1–0.3 million respectively. Recent research has further estimated one-off and annual recurring costs and estimated net costs of EUR 10.53 million (net present value of costs – benefits) for the governments and regulators across the EU over 15 years (2009–2015).[685]

Quantification of costs and benefits

Given that the implementation costs of this option are basically the same as the previous one. The same explanations regarding the quantification of costs for the creditors apply.

Consumers and society in general will face aggregate benefits of EUR 187–249 million. However, considering the fact that a basis points reduction already includes the 10–15 basis points fall identified as the reduction due to the implementation of Option 1.2. The incremental benefits attributable to Option 1.3 are in the range of EUR 52–63 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 15–20 basis points due to creditors refraining from lending in the event of a negative creditworthiness assessment.

– This is equivalent to mortgages of EUR 187–249 million[686].

– This figure is based on the assumption that 90 % of lenders already conduct creditworthiness assessments and that they would deny credit in the event of a negative outcome, even in those Member States where there is currently no obligation to do so.[687] This is therefore a conservative assumption since a negative creditworthiness assessment does not automatically leads to the rejection of the loan application.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[688].

Consumers will also benefit from the increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased

[682] Established by case law.
[683] See footnote 136.
[684] See footnote 136.
[685] See footnote 136.
[686] See footnote 277.
[687] See footnote 673.
[688] See footnote 268.

opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors will face one-off costs of EUR 104 million and annual recurring costs of EUR 11 million. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 104 million. This is based on the assumption that each credit institution must provide 8 hours training to 20 % of its staff. It is also based on the assumption that each credit institution requires 300 man days to create, prepare, and configure new IT systems and Standard Operating Procedures.

– Incremental annual recurring costs are estimated at EUR 11 million. This is based on the assumption are based on the assumption that undertaking a thorough creditworthiness check takes 0.5 hours per mortgage contract and refraining from lending would not add additional time. It is also assumed that ensuring compliance takes about 0.5 hours and that 10 % of mortgage contracts are checked.

– This figure is based on the assumption that 90 % of lenders already conduct creditworthiness assessments, even in those Member States where there is currently no obligation to do so.[689]

– In case the instrument is self-regulation or recommendation, the cost will most likely lie at around the lower end of the aforementioned value ranges[690].

According to Commission services' estimates Member States will face EUR 0.4 million in one-off costs and EUR 0.2–0.3 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.4 million. This is based on the assumption in a recent study[691] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, 18 Member States[692] would have to introduce a requirement to refrain from lending in the event of a negative creditworthiness assessment.

– Annual recurring costs of EUR 0.2–0.3 million. These based on the assumption that the administrations incur costs equivalent to 1–3 man hours per institution.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

689 See footnote 673.
690 See footnote 268.
691 See footnote 136.
692 Belgium, Bulgaria, Denmark, Ireland, Greece, Spain, Italy, Latvia, Lithuania, Luxembourg, Hungary, Malta, Austria, Portugal, Romania, Slovenia, Slovakia and Finland.

The EUR 10.53 million costs for Member States quoted in an external cost benefit analysis[693] is based on the following assumptions.

– The figure is a NPV of regulator costs over a 15-year period from 2009 to 2014.

– The one-off and annual recurring costs are based on the results of a questionnaire to regulators. As relatively few quantitative responses were received, the highest figures received are applied to all countries to generate an upper bound of the likely cost. For this policy option, one-off costs are estimated at EUR 23 529 and annual recurring costs are estimated at EUR 30 000. Annual cost estimates were discounted using a real interest rate of 4 %.

– The difference between the results of the external cost benefit analysis and that of Commission services reflect the fact that nine Member States (Cyprus, Czech Republic, France[694], Germany, Estonia, the Netherlands, Poland, Sweden and United Kingdom) have a legal requirement in place to refrain from lending in the event of a negative creditworthiness assessment.[695] Five Member States (Belgium, Germany, Hungary, Latvia and Slovakia) have self-regulatory codes or practices in place.[696]

4.9.1.4. Option 1.4: Non-discriminatory access to databases for creditors

Effectiveness of policy option

The purpose of credit data sharing is to support creditors in analysing a borrowers' creditworthiness. Information sharing about borrowers' characteristics and their indebtedness has important effects on credit markets activity. First, it improves the creditors' knowledge of the borrower's characteristics and permits a more accurate prediction of their repayment probabilities if the data is accurate and up-to-date. It therefore assists creditors in complying with responsible lending obligations. Second, it helps creditors acquire information more quickly and often at a lower cost. Third, in the case of default data sharing, it can operate as a borrower discipline device. Finally, it reduces the risk that borrowers become overindebted by drawing credit simultaneously from too many creditors.[697]

Credit information not only helps to determine an individual's payment capacity and characteristics, but also affects the overall incentives of economic performance. On the one hand, consumers may be encouraged to meet his/her obligations when s/he knows that the noncompliance with his/her obligations will be entered into a database that may be accessed by creditors (and in some cases also service suppliers). On the other hand, it is in the interest of non-defaulting consumers that firms with whom they want to deal have access to their personal data showing that they have duly fulfilled their obligations. In this way, they will obtain lower rates and better conditions for the purchase of goods and services as creditors will be able to apply risk-based prices and, thus, would incur lower risks and costs. It may also lead creditors to shift from collateral-based lending policies to more information-based policies, which has a direct impact on the cost of credit or service and will lead to objective credit decisions.

693 See footnote 136.
694 Established by case law.
695 See footnote 136.
696 See footnote 136.
697 See footnote 644.

Introducing a requirement for Member States to ensure non-discriminatory access to databases for creditors will therefore contribute to the specific objective of ensuring that creditors and borrowers take appropriate lending and borrowing decisions and contribute to the fulfilment of the first three operational objectives listed in Section 4.6.

Credit registers remain nationally based with only a few credit registers engaging in cross-border activity. According to data provided by ACCIS[698] on March 2010, only nine of its members (from nine different Member States) have signed a total of eleven bilateral contracts to exchange information. Despite those arrangements, requests for information remain a very small percentage of overall enquiries. The number of enquiries from the Dutch credit register to the Belgian one (the National Bank of Belgium) represented 0.17 % of total amount of consultations received by the National Bank of Belgium in the years 2005 to 2007[699]. The low levels of cross-border activity can be attributed both to the low level of demand for information, as well as, the presence of regulatory barriers[700]. Non-discriminatory access to databases for creditors across borders will therefore tackle one of the barriers to the cross-border mobility of both creditors and consumers. The elimination of restrictions to database access will also ensure a level playing field for market participants.

Despite the positive effect of a greater access to credit registers on many of the defined objectives, this option may not completely solve the problem. As explained in the problem section, the use by credit registers of different definitions and registration criteria may render the information obtained from a foreign database difficult to exploit.

Impacts of policy option on stakeholders and efficiency

Article 9 of the CCD provides already for non-discriminatory database access in case of consumer credit. This provision is applied (or will be) to mortgage credit by 18 Member States[701]. Therefore, only stakeholders in the remaining nine Member States[702] may incur incremental costs due to this policy option.

Credit registers may benefit from increased business if foreign creditors take the opportunity of the introduction of non-discriminatory access to enter new markets on a cross-border basis. Estimates developed on the basis of responses received to the survey of credit registers that one-off and annual recurring costs range from EUR 50 000 to EUR 300 000 for one-off costs and EUR 20 000–300 000 for annual recurring costs.[703] As non-discriminatory access to databases for creditors is required by the CCD, credit registers holding such databases have already been developing the necessary infrastructure, systems and procedures to provide non-discriminatory access to cross-border consumer credit providers. Within the arrangements already in place, the costs of extending this access to creditors assessing mortgage credit requests should therefore not be significant. Where no exchange arrangements exist, investments will take place in parallel to the increase of the demand. As discussions with credit registers have shown, in the absence of a critical mass of consultation demands, the investments will not take place. This means that for some time part of the cross-border data

698 Association of Consumer Credit Information Suppliers.
699 See footnote 644.
700 See footnote 644.
701 Belgium, Bulgaria, Denmark, Germany, Estonia, Spain, Italy, Cyprus, Latvia, Hungary, Malta, the Netherlands, Austria, Romania, Slovenia, Finland, Sweden and the United Kingdom.
702 Czech Republic, Ireland, Greece, France, Lithuania, Luxembourg, Poland, Portugal and Slovakia.
703 See footnote 136.

exchange would continue to involve a lot of manual intervention (i.e. accessing online services and sending reports by fax/secure email).

While the proposal does not raise particular costs for creditors (according to views expressed by creditors in consultation of the London Economics study), creditors will benefit from obtaining creditworthiness information for cross-border transactions, especially in the case of registers with positive data.[704] As the Expert Group on Credit Histories has pointed out, better access to credit data will have a variety of benefits for creditors such as reducing information asymmetry, measure and price the underlying risk of an account objectively thereby minimising lending risks, effectively manage cross-institution exposures, improve credit portfolio and enhance credit risk management practices in line with global best practices.[705] Creditors will also be in a position to consider new business opportunities both domestically and cross-border as they will be able to access information on more borrowers.

The Expert Group on Credit Histories has pointed out several benefits to consumers that arise from credit information sharing that include easier access to credit (for compliant borrowers or previously excluded groups of customers) if the data available is accurate and up-to-date, contributing to obtaining a price that reflects better their individual circumstances, helping them to better understand the need to manage their credit, reducing the use of guarantees, expanding their access to a wide range of (affordable) services and products (for compliant borrowers), preventing over-indebtedness and enhancing responsible borrowing, reducing the need to provide extensive physical proofs or evidence.[706]

In a cross-border context, information sharing may also raise additional concerns regarding privacy and consumer protection. It might be not clear for consumers to which companies their information is transferred, whether it is shared with third parties and whether these, in turn, share it with other institutions. Access to the information as well as rectification of errors or outdated information cross-borders might put additional burden on consumers. Different data content and definitions may render difficult a proper assessment of the credit application. The risk of discrimination based on inaccurate information is therefore higher.[707]

Recent research has arrived at the conclusion that the costs and benefits of a non-discriminatory access to credit registers are likely to be marginal for consumers. While consumers may incur costs when verifying the information credit registers hold about them, this is the case irrespective if whether cross-border access is provided or not. Moreover, the impact on consumer confidence is also likely to be neutral unless data access is abused to support irresponsible lending practices and/or violate data protection in which case the impact would be negative.[708] A greater access to databases is estimated to have a moderate impact in terms of reducing the risk of default. The reason for this is that in the absence of appropriate data, the creditor may conclude that the risk is too high and therefore deny the credit. However, as explained before other effects, such as the willingness to increase its market share, may push the creditor to grant the loan, even if often at a higher interest rate. Moreover, in some instances, the creditor may also be able to obtain the relevant information from the borrower and thus decide to proceed with the granting the credit. Nevertheless, consumers and society at large are expected to benefit from the reduction of the default rate that a greater

[704] See footnote 136.
[705] See footnote 644.
[706] See footnote 644.
[707] See footnote 644.
[708] See footnote 136.

access to data relevant to the creditworthiness of the borrower will achieve. Thus, the anticipated benefits from this reduction are EUR 123–205 million.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 123–205 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 3 basis points due to more thorough assessments of creditworthiness being undertaken.

– This is equivalent to mortgages of EUR 123–205 million[709].

– This figure incorporates a discount to take into account the fact that this provision is applied (or will be) to mortgage credit by 18 Member States[710].

Consumers will also benefit from the increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors will face one-off costs as well as annual recurring costs. It is however difficult to estimate those costs as they would be dependent on the access model chosen. Moreover, it is important to emphasise that the choice to consult a credit database generally lies with the creditor (except in some countries, such as Belgium[711], where an obligation to consult a credit database exists). Consequently, incremental costs to creditors would lie with the creditor, or in the case of the Netherlands and Belgium, with the national regulator rather than this specific policy option.

Credit registers not yet providing full access on a non-discriminatory basis will incur some one-off and some annual recurring costs. For all credit registers in the EU27, the net present value of aggregated cost has been estimated to range from zero to EUR 115 million over 15 years (2009–2014).[712] Estimates developed on the basis of responses received to the London Economic survey of credit registers range from EUR 50 000 to EUR 300 000 for one-off costs and EUR 20 000–300 000 for annual recurring costs.[713] These figures are based on the following assumptions.

– The figure is a NPV of costs over a 15-year period from 2009 to 2014.

– The one-off and annual recurring costs are based on the results of a questionnaire to credit registers. The costs reflect the one-off and recurring costs per credit register. Annual cost estimates were discounted using a real interest rate of 4 %.

[709] See footnote 277.

[710] Non-discriminatory access is not or will not be available for mortgage creditors in nine Member States, see footnote 702.

[711] Art. 9 Loi du 10 août 2001 relative à la Centrale des Crédits aux Particuliers.

[712] See footnote 136.

[713] See footnote 136.

– The costs for the credit registers may vary across Member States. The results take account of the fact that the number of credit registers per Member State varies across the EU. Table 29 provides an overview per Member State.

Table 29: Net present value of total costs to credit registers (million EUR) by Member State

Member State	Number of credit registers	Legislated	
		Direct access	Indirect access
Austria	3	8.2	5.9
Belgium	1	2.7	2.0
Bulgaria	2	5.4	4.0
Czech Republic	2	5.4	4.0
Denmark	2	5.4	4.0
Estonia	1	2.7	2.0
France	1	2.7	2.0
Germany	4	10.9	7.9
Greece	1	2.7	2.0
Hungary	1	2.7	2.0
Italy	5	13.6	9.9
Latvia	5	13.6	9.9
Netherlands	1	2.7	2.0
Poland	1	2.7	2.0
Portugal	2	5.4	4.0
Romania	2	5.4	4.0
Slovakia	6	16.3	11.9
Slovenia	2	5.4	4.0
Total	42	113.9	83.5

Source: London Economics, November 2009.

According to Commission services' estimates Member States will face EUR 0.2 million in one-off costs and EUR 0 in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.2 million. This is based on the assumption in a recent study[714] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, nine Member States[715] would have to facilitate non-discriminatory access to databases.

– Annual recurring costs of EUR 0. These based on the assumption that Member States would only intervene on the basis of complaints about the lack of non-discriminatory access.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

[714] See footnote 136.
[715] See footnote 702.

4.9.1.5. Option 1.5: Homogenise the content and characteristics of databases

Effectiveness of policy option

As explained under Option 1.4, granting creditors non-discriminatory access to databases may not solve all the problems linked to the need to gather the appropriate information to conduct creditworthiness assessments. As explained in the problem description section, credit registers in different countries may contain different type of data (negative or positive), have different registration thresholds, update frequencies or storage limits. Also for the same data items, the definitions may be different (e.g. late payments to be considered as such when the payment is due since 30 days or since 3 months). That is why the EGCH in its report recommended a greater convergence of the content databases and "In particular with reference to the concepts and definitions used (e.g. bad debt, arrears, default, loan types…), as well as to data retention periods."[716]

While Option 1.5 on its own will not have a great impact, it would reinforce the effectiveness of Option 1.4 in achieving the defined objectives, in particular, the specific objective of ensuring that creditors take appropriate lending decisions. At the level of the general objectives, the impact of the combination of both options will be significant not only in fostering the cross-border activity of creditors but also the mobility of consumers. Thus, it would be easier for a British consumer wishing to buy a holiday home in Spain to obtain a credit from a Spanish bank since this can access and exploit the data from a UK database.

This option will make also an important contribution to achieving the objective of a level playing field. Particular if convergence is achieved in terms of the type of data contained in credit registers. While a majority of EU credit registers provide both negative and positive information, the possibility to gather and exchange positive date does not exist in Denmark, Finland, France or Malta[717]. Access to credit registers containing only negative data is of limited usefulness to cross-border creditors and leaves them at a competitive disadvantage relative to a domestic creditor that may have a more complete picture of a consumer's credit history.

Despite all the above describe positive effects. The main obstacle to implementing Option 1.5 is the difficulty to agree on the standards for data content and data registration to be applied across the EU. Doubts on the feasibility of this option, at least in the short term, were expressed during the EGCH discussions.

Impacts of policy option on stakeholders and efficiency

A number of the necessary changes could be achieved by credit registers directly. However, some of the characteristics of credit registers are defined by law. This means that Member States will incur the costs necessary to change, even if small concrete changes would be often needed, of those laws. However, these costs could be minimised if to define the standard the maximum common denominator is chosen; e.g. a majority of credit registers already update their information at least monthly[718].

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716 See footnote 644.

717 See footnote 644. It should be also noted that, in France, there are discussions at political level on how to create a positive database.

718 See footnote 644.

Positive impacts for both creditors and borrowers are expected. Creditors will be able to enlarge their business opportunities and offer more easily credit across borders. Consumers would not only benefit from the enlarger offer and the competition foreign market entrants will bring about but will be also able to shop around across borders for the best deal. Benefits can also be expected from the resulting better creditworthiness assessments. Even if small, the reduction of the default rate could bring creditors and consumers a benefit of EUR 45 million.

On the other hand, implementing Option 1.5 will have a negative impact on credit registers, which will have to adapt their databases and internal processes. Considering that in most countries there is just one or two credit registers, the costs are probably to be passed on to creditors, at least in the case of private credit registers[719]. It can therefore be expected that part of the benefits identified for creditors (and consumers) will be offset.

Quantification of costs and benefits

A convergence of content and features of databases is estimated to be less effective than a greater access to databases in terms of reducing the risk of default. In fact, cross-border exchanges of data already exist and differences are accommodated.

Consumers and society in general will face aggregate benefits of EUR 311–436 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 2.5–3.5 basis points due increasingly homogenous data in credit databases.

– This is equivalent to mortgages of EUR 311–436 million.[720].

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[721].

Creditors will face no costs as it is assumed that all costs are borne by the credit registers. In practice, some or all of the costs incurred by credit registers may be passed on to creditors however quantification is not feasible.

Credit registers will face estimated one-off costs of EUR 3 million and no recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.6 million. This is based on the assumption that all 42 credit databases[722] in the EU will need to be modified. It is also assumed that it will take 300 man days (of 8 hours a day) per credit register to modify the systems. The price is assumed to be equal to the cost of the wage in the financial sector (EUR 31.56 per hour).

[719] See footnote 644 for more information on the number of credit registers by Member State and on their public or private nature.
[720] See footnote 277.
[721] See footnote 268.
[722] See footnote 136.

– Annual recurring costs of EUR 0. These based on the assumption that no monitoring or enforcement is required once the modifications have been undertaken.

According to Commission services' estimates, Member States will face EUR 0.6 million in one-off costs and EUR 0 in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.6 million. This is based on the assumption in a recent study[723] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, all 27 Member States would have to modify their frameworks.

– Annual recurring costs of EUR 0. These based on the assumption that no monitoring or enforcement is required.

4.9.1.6. Option 1.6: Requirement for the borrower to provide correct information on his/her situation

Effectiveness of policy option

An obligation for the borrower to provide correct information should in general tackle incentives consumers may potentially have to overstate income or hide information from the creditor. This would contribute to the fulfilment of two operational objectives: ensuring that conflicts of interest do not influence borrowing decisions and ensuring creditors' access to appropriate information. This should also underpin the specific objective (i.e. ensure that creditors and borrower take appropriate lending and borrowing decisions).

As regards the existence of conflicts of interest that influence borrowing decisions, a recent study concluded that at least in a price bubble situation, a regulation trying to enforce data disclosure by the borrower would have to work against strong incentives – on borrower and creditor side – to falsify income documentation in extreme market situations.[724] Against this background, the legal implications of the proposed obligation are not entirely clear, for example the implication for the liability of creditors for own negligence. The study thus arrived at the conclusion that this would only be the case if there was outright fraud by the borrower. Fraud, however, seems to be sufficiently penalised already by civil and penal codes.[725] At the same time though, in a disintermediated market where risk is borne by third-party investors, credit intermediaries and creditors may have their incentives aligned with consumers willing to conceal information. Forcing the borrower to disclose information would reduce creditor/intermediary moral hazard. This would certainly also contribute to achieve the objective of ensuring a level playing field for market participants.

An obligation for borrower disclosure would also help facilitate creditor access to information. Increased borrower information duties may have a positive impact on the likelihood of cross-border lending if foreign creditors fear to be adversely selected against for fraud.[726] This could lead to improved cross-border activity by creditors.

[723] See footnote 136.
[724] See footnote 136.
[725] See footnote 136.
[726] See footnote 136.

An obligation for the borrower to provide correct information will contribute to ensuring that creditors and borrowers take suitable lending and borrowing decisions. However, the collusion incentives for consumers and creditors may be overwhelming and make the rule inefficient.[727]

Impacts of policy option on stakeholders and efficiency

As showed in Table 30, ten Member States[728] have a legal requirement specifically providing for borrower disclosure with regard to mortgage credit. In addition, four Member States have industry self-regulatory guidelines or recommendations[729]. Thirteen Member States have currently no legal requirements or self-regulatory guidelines/recommendations.[730] These Member States would therefore incur, according to the London Economics study, in moderate to low costs of implementing the provision[731].

[727] See footnote 136.

[728] Bulgaria, Czech Republic, Germany, Ireland, France, Latvia, the Netherlands, Poland, Portugal and the United Kingdom.

[729] Belgium, Cyprus, Hungary and Slovakia.

[730] Denmark, Estonia, Greece, Spain, Italy, Lithuania, Luxembourg, Austria, Romania, Slovenia, Finland and Sweden. No information is available on Malta so it is assumed that they do not currently have provisions in place in order to ensure that costs are not underestimated.

[731] See footnote 136.

Table 30: Overview of requirements for the borrower to provide correct information

Member State	Borrower disclosure requirements
Austria	No requirement in regard to mortgages
Belgium	Industry self-regulation
Bulgaria	Legal requirement
Cyprus	Industry self-regulation
Czech Republic	Legal requirement
Germany	From 2010, a legislative requirement
Denmark	No legal requirement
Estonia	No legal requirement
Greece	No legal requirement
Spain	No legal requirement
Finland	No legal requirement
France	Established by case law
Hungary	Industry Code of Ethics
Ireland	Legislative requirement
Italy	No requirement
Lithuania	No requirement
Luxembourg	No requirement specifically in regard to mortgage provision
Latvia	Legal requirement
Malta	No information provided
Netherlands	Legal requirement
Poland	Legislative requirement
Portugal	Legal requirement
Romania	No requirement specifically in regard to mortgage provision
Sweden	No legal requirement
Slovenia	No legal requirements specifically for mortgage provision
Slovakia	Industry guidelines
United Kingdom	Case Law (Common Law) requirement

Source: London Economics Legal Baseline survey, p. 344–345.

The fact that there is currently no legal requirement for borrower disclosures in some Member States does not necessarily mean that that the creditors do not practice/require such borrower disclosure. The accuracy of creditor's creditworthiness and suitability assessments would benefit from greater and more accurate information set concerning borrower characteristics. This could in turn reduce the overall credit risk creditors are exposed to.

For creditors as well as credit intermediaries, a requirement for consumers to provide correct information could potentially lead to some reduction in screening costs, and possibly additional options to shed liability for mis-selling. If not sufficiently specified, a list of specific borrower information obligations could be further detailed contractually, possibly in fine print hard to discern for consumers and thus lead de facto omnibus elimination of creditor/intermediary liability and reversal of the onus even for minor information not provided.

Unless a clear borrower penalty is specified, borrower disclosure rules will have no direct consequences. However, one negative outcome for the consumer could be greater difficulty to prove and enforce justified claims for creditor or intermediary liability which may limit the value of the provision. For consumers, such an obligation may entail some costs, particularly if he/she needs to provide a proof (e.g. salary statement, certificates…). But these are considered to be small. On the other hand, the implementation of this obligation may reduce creditors mistrust and thus increase consumers' access to credit.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 60–120 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 1–2 basis points due to the provision of information by borrowers.

– This is equivalent to mortgages of EUR 60–120 million[732].

– This figure incorporates a discount to take into account the fact that 14 Member States[733] have a legal or self-regulatory requirement in place.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[734].

Creditors will face one-off costs of EUR 34 million and annual recurring costs of EUR 67–112 million. These costs can be broken down as follows.

– One-off costs will amount to approximately EUR 34 million. This is based on the assumption that each credit institution must provide 8 hours training to 20 % of its staff. It is assumed that there will not be any IT or systems adjustment costs.

– Incremental annual recurring costs are estimated at EUR 51 million. This is based on the assumption are based on the assumption that undertaking a thorough creditworthiness check takes 0.5 hours per mortgage contract. These costs amount to EUR 47 million. It is also assumed that ensuring compliance takes about 0.5 hours and that 10 % of mortgage contracts are checked and thus accounts for EUR 5 million in costs.

According to Commission services' estimates Member States will face EUR 0.4 million in one-off costs and EUR 0 in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.4 million. This is based on the assumption in a recent study[735] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, 17 Member States[736] would have to introduce a requirement for borrowers' disclosures.

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[732] See footnote 277.

[733] The following ten Member States have a regulatory requirement in place: Bulgaria, Czech Republic, Germany, Ireland, France, Latvia, the Netherlands, Poland, Portugal and the United Kingdom. The following Member States have a self-regulatory requirement in place: Belgium, Cyprus, Hungary and Slovakia.

[734] See footnote 268.

[735] See footnote 136.

[736] Belgium, Denmark, Estonia, Greece, Spain, Italy, Cyprus, Lithuania, Luxembourg, Hungary, Malta, Austria, Romania, Slovenia, Slovakia, Finland and Sweden.

– Annual recurring costs of EUR 0. These based on the assumption that the administrations do not need to monitor whether borrowers are providing all the relevant information.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

According to an external cost benefit analysis[737], the total costs for regulators would be EUR 0. This is based on the following assumption.

– The one-off and recurring costs are based on the results of a questionnaire to regulators. As relatively few quantitative responses were received, the highest figures received are applied to all countries to generate an upper bound of the likely cost. For this policy option, one-off costs are estimated at EUR 0 and annual recurring costs are estimated at EUR 0.

4.9.2. Suitability assessment

4.9.2.1. Option 2.1: Do nothing

Effectiveness of policy option

Most of the operational objectives will not be achieved if the status quo is maintained. Conflicts of interest risk continuing influencing lending and borrowing decisions and, except in the Member State where specific provisions already exist, the suitability of the credit products offered will remain untested. This will render difficult the achievement of the specific objective of ensuring that creditors and borrowers take appropriate lending and borrowing decisions. The rate of default and the number of foreclosures are expected to continue to be strongly influenced by the economic cycle and, therefore, during crisis periods, the financial stability of the whole system could be in danger.

In addition, doubts about the impartiality of the creditor or the credit intermediary will undermine consumer confidence. Maintaining the current patchwork of different frameworks regarding suitability requirements will also hinder creditors and credit intermediaries' mobility, reducing thus their business opportunities. As a result, the general objective of creating an efficient and competitive Single Market for consumers, creditors and credit intermediaries will remain far from be fulfilled.

Impacts of policy option on stakeholders and efficiency

Many of the regulatory and market failures identified would remain unaddressed if the status quo is maintained. In those countries where there are no legal provisions[738] on the need to assess the suitability of credit products, borrowers will face a too high risk of ending up with products not really adapted to their needs or circumstances. For those consumers, there will be

[737] See footnote 136.

[738] Belgium, Czech Republic, Spain, Italy, Latvia, Lithuania, Luxembourg, Austria, Slovenia, Slovakia and Finland. No information is available on Malta so it is assumed that they do not have a framework in place in order to potentially overestimate rather than underestimate costs.

therefore a higher risk of being overindebted, of having problems to reimburse the credit instalments and, in the worst case scenario of defaulting and losing their home.

Creditors and credit intermediaries will be able to continue aggressive selling practices and thus enlarge their profits and, in some cases, also their market share. However, in the long run, serious negative impacts could be expected on creditors if the unsuitable loans translate into defaults. The impact of growing default rates can also put in danger financial stability, which will have a damaging effect on the rest of the economy.

No impacts can be expected at the level of Member States unless risks to financial stability emerge and financial services entities need to be recued with taxpayers' money. Table 28 provides an overview of those fiscal costs.

4.9.2.2. Option 2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered

Effectiveness of policy option

Providing principles for the performance of an assessment whether a product is suitable given the consumer's individual needs and circumstances would contribute to achieving the operational objectives of minimising conflicts of interest and adequately assess the product suitability. This would therefore contribute to the fulfilment of the specific objective to ensure that creditors and borrowers take appropriate lending and borrowing decisions.

On the one hand, an EU-wide requirement for suitability checks and is likely to encourage cross-border activity. It would create a level playing field for creditors and credit intermediaries, offering opportunities for synergies when engaging in cross-border business. It would also increases the confidence of consumers in products that they are being provided with, thus encouraging mobility both on a domestic and, albeit to a lesser extent, cross-border level. On the other hand, such regulation may render market entry less attractive. Preferences, needs and circumstances of consumer vary widely within and across Member States. A need to assess product suitability in different Member States will certainly increase further the necessity to familiarise with local particularities which may in turn reduce the incentive to engage in cross-border activity. London Economics has referred to the example of Regulation S in Poland that imposed a stress test on foreign exchange denominated loans that seems to have reduced the entry dynamics of foreign banks in this segment.[739] In addition, the introduction of such requirement would make it more difficult for creditors to try raising their market share by neglecting product suitability (this would however be to the benefit of consumers who should be offered more suitable products for their needs).

This policy option will therefore contribute to achieving the objective of a level playing field and encouraging cross-border activity by creditors and credit intermediaries while, at the same time, having a positive impact on consumer confidence and mobility.

Impacts of policy option on stakeholders and efficiency

An EU-wide requirement to carry out suitability assessments will not introduce important changes in a number of Member States. Thirteen Member States[740] require already specific

739 See footnote 136.
740 See footnote 625.

risk warnings to be issued to consumers (and it can be assumed that some kind of suitability assessment has therefore been conducted beforehand). Member State administrations would still need to supervise and enforce the principles for the suitability assessment. Member States will face estimated EUR 0.3 million in one-off costs and EUR 0.3–1 million in annual recurring costs.

Creditors and credit intermediaries would face implementation costs under this option. They would need to perform a gap analysis to determine in how far their current practices deviate from the principles-based requirements and adjust their practices accordingly. Those creditors that are currently not carrying out suitability assessment would need to build up respective systems and procedures from the scratch. It is estimated that creditors will face one-off costs of EUR 219 million and annual recurring costs of EUR 28 million and that credit intermediaries will face one-off costs of EUR 118 million and annual recurring costs of EUR 54 million. Additionally, in a recent study it is reported that the mortgage intermediary industry would be negatively affected by a shift in consumer preferences towards safer products which allows creditors to charge lower credit margins only as a result of higher interest rates already paid for greater interest rate risk protection.[741]

On the one hand, both consumers and society in general would benefit from the introduction of the requirement to conduct suitability assessment as fewer unsuitable products will be sold. This may lead to benefits of EUR 383–493 million for the EU27. Moreover, suitability assessment may lead to shift in consumer's preferences towards less risky products. This would in turn have further impacts upon the market. On the other hand, requiring suitability checks may also have a negative impact on consumers since there is a very small risk that access to credit for some groups of consumers (e.g. low income) is reduced as consumers realise that the products they are considering may not necessarily be in their best interests. Under such circumstances the consumer is however likely to opt for a more suitable product rather than decide against taking out any credit at all.

<u>Quantification of costs and benefits</u>

The suitability assessment by itself is expected to be less effective than creditworthiness in terms of reducing the risk of default. Consumers and society in general will face aggregate benefits of EUR 383–493 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 7–9 basis points due to provision of more suitable products.

– This is equivalent to mortgages of EUR 383–493 million[742].

– This figure incorporates a discount to take into account the fact that 15 Member States[743] have a legal or self-regulatory requirement to provide risk warnings. This implies that some form of suitability assessment is undertaken.

[741] See footnote 136.
[742] See footnote 277.
[743] See footnote 625.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[744].

Consumers will also benefit from the increased customer mobility and increased competition between providers. Similarly, there will be benefits to providers in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Both these benefits are however difficult to quantify. A full explanation of the difficulties in quantifying these benefits is available in detail in Annex 5.

Creditors will face one-off costs of EUR 219 million and annual recurring costs of EUR 28 million. Credit intermediaries will face one-off costs of EUR 118 million and annual recurring costs of EUR 54 million. These costs can be broken down as follows.

– One-off costs for creditors will amount to approximately EUR 219 million. This is based on the assumption that each institution must provide 8 hours training to 20 % of its staff. One-off costs for credit intermediaries will amount to approximately EUR 118 million. This is based on the assumption that each credit intermediary must provide 8 hours training to 80 % of its staff. It is also based on the assumption that each credit institution requires 200 man days and each credit intermediary requires 67 man days to create, prepare, and configure new IT systems and Standard Operating Procedures. It is assumed that this will take two thirds of the time required for adjustments for creditworthiness assessments as it is assumed that more work will have to be undertaken manually.

– Incremental annual recurring costs for creditors are estimated at EUR 28 million and EUR 54 million for credit intermediaries. This is based on the assumption are based on the assumption that undertaking a thorough creditworthiness check takes 0.5 hours per mortgage contract. It is further assumed that creditors undertake this for all mortgage transactions and credit intermediaries undertake the assessment for all intermediated mortgage transactions. These costs amount to EUR 25 million and EUR 49 million respectively. It is also assumed that ensuring compliance takes about 0.5 hours and that 10 % of mortgage contracts are checked. These costs amount to EUR 3 million for credit institutions and EUR 5 million for credit intermediaries respectively.

– This figure incorporates a discount for the creditors to take into account the fact that 15 Member States[745] have a legal or self-regulatory requirement for creditors to provide risk warnings. This implies that some form of suitability assessment is undertaken. These figures also incorporate a discount for credit intermediaries to reflect the fact that credit intermediaries are currently only required to conduct a suitability assessment in six Member States[746].

According to Commission services' estimates Member States will face EUR 0.3 million in one-off costs and EUR 0.3–1 million in annual recurring costs. These costs can be broken down as follows.

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744 See footnote 268.

745 See footnote 625.

746 Belgium, Ireland, Hungary, Malta, the Netherlands and Austria (only applicable to mortgage credit intermediaries). See footnote 6.

– One-off costs of EUR 0.3 million. This is based on the assumption in a recent study[747] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, 14 Member States[748] would have to introduce a requirement for a suitability assessment (NB. this is based on the assumption that 13 Member States[749] have a legal requirement for creditors to provide risk warnings and that in order to provide a risk warning, a suitability assessment needs to be conducted).

– Annual recurring costs of EUR 0.3–1 million. These based on the assumption that it takes between 1 and 3 hours to monitor and enforce these rules.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

4.9.2.3. Option 2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her

Effectiveness of policy option

Since this option implies that a suitability assessment has been carried out, most of the arguments developed in the analysis of the effectiveness of Option 2.2 are valid. Implementing this option however will better achieve the operational objectives of minimising conflict of interests and adequately assessing suitability as in addition to the suitability test itself, the creditor/credit intermediary would be required to provide a warning if the borrower chooses an unsuitable product. Thus, Option 2.3 will more completely fulfil the specific objective of ensuring appropriate lending and borrowing decision than Option 2.2.

Impacts of policy option on stakeholders and efficiency

For Member States the impact of this policy option will be limited. Thirteen Member States[750] require already specific risk warnings to be issued to consumers. Despite the fact that Member State administrations would still need to supervise and enforce the implementation of this requirement, the overall costs should be small. According to Commission estimates, Member States will face EUR 0.3 million in one-off costs and EUR 0.3–1 million in annual recurring costs. A recent study further estimates the net present value of costs–benefits over a 15-year period (2009–2014) at EUR 0.54 million.[751]

Under this option, creditors would face implementation costs. These will however depend on the type of warning that would need to be provided to the consumer. If this is an oral warning, the implementation costs will be closely those linked to the implementation of Option 2.2. under which creditors will face one-off costs of EUR 219 million and annual recurring costs of EUR 28 million, and credit intermediaries will face one-off costs of EUR 118 million and annual recurring costs of EUR 54 million. If the warning needs to be documented, then small

[747] See footnote 136.
[748] Belgium, Germany (currently has self-regulation), Estonia (currently has self-regulation), Greece, Spain, Italy, Lithuania, Luxembourg, Malta, Austria, Romania, Slovenia, Finland and Sweden.
[749] See footnote 625.
[750] See footnote 625.
[751] See footnote 136.

additional costs can be expected. These would be basically the one-off cost of drafting a standard letter and the ongoing cost of printing it each time the borrower has chosen a product that is not suitable to him/her. The first cost has been estimated at something less than EUR 0.7 million.[752] The second one is considered to be negligible. In addition, as also indicated above, the mortgage intermediary industry would be negatively affected by a shift in consumer preferences towards safer products.[753]

On the one hand, both consumers and society in general would benefit from the introduction of a requirement to warn consumers as fewer unsuitable products will be sold, reducing the risk of overindebtedness, default and potentially foreclosure. This may lead to benefits of EUR 442–553 million for the EU27. The introduction of a warning obligation may also lead to shift in consumer's preferences towards less risky products, as explained under Option 2.2.

<u>Quantification of costs and benefits</u>

The introduction of compulsory risk warnings is expected to be slightly more effective than just requiring a suitability assessment to be carried out.

Consumers and society in general will face aggregate benefits of EUR 442–553 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 8–10 basis points due to the provision of information by borrowers.

– This is equivalent to mortgages of EUR 442–553 million.[754]

– This figure incorporates a discount to take into account the fact that 15 Member States[755] have a legal or self-regulatory requirement in place.

– In case the instrument is self-regulation or recommendation, the benefits will most likely lie at around the lower end of the aforementioned value range[756].

Costs to creditors and credit intermediaries will be largely the same as the previous option since the additional costs of providing a warning (unless the warning has to be documented) would be negligible. Creditors will face one-off costs of EUR 219 million and annual recurring costs of EUR 28 million. Credit intermediaries will face one-off costs of EUR 118 million and annual recurring costs of EUR 54 million. These costs can be broken down as follows.

– One-off costs for creditors will amount to approximately EUR 219 million. This is based on the assumption that each institution must provide 8 hours training to 20 % of its staff. One-off costs for credit intermediaries will amount to approximately EUR 118 million. This is based on the assumption that each credit intermediary must

752 Assuming that in each creditor and credit intermediary a man-hour will be needed to finalise that standard letter.
753 See footnote 136.
754 See footnote 277.
755 See footnote 625.
756 See footnote 268.

provide 8 hours training to 80 % of its staff. It is also based on the assumption that each credit institution requires 200 man days and each credit intermediary requires 67 man days to create, prepare, and configure new IT systems and Standard Operating Procedures. It is assumed that this will take two thirds of the time required for adjustments for creditworthiness assessments as it is assumed that more work will have to be undertaken manually.

– Incremental annual recurring costs for creditors are estimated at EUR 28 million and EUR 54 million for credit intermediaries. This is based on the assumption are based on the assumption that undertaking a thorough creditworthiness check takes 0.5 hours per mortgage contract. It is further assumed that creditors undertake this for all mortgage transactions and credit intermediaries undertake the assessment for all intermediated mortgage transactions. These costs amount to EUR 25 million and EUR 49 million respectively. It is also assumed that ensuring compliance takes about 0.5 hours and that 10 % of mortgage contracts are checked. These costs amount to EUR 3 million for credit institutions and EUR 5 million for credit intermediaries respectively.

– This figure incorporates a discount for the creditors to take into account the fact that 15 Member States[757] have a legal or self-regulatory requirement for creditors to provide risk warnings. This implies that some form of suitability assessment is undertaken. These figures also incorporate a discount for credit intermediaries to reflect the fact that credit intermediaries are currently only required to conduct a suitability assessment in six Member States[758].

According to Commission services' estimates Member States will face EUR 0.3 million in one-off costs and EUR 0.3–1 million in annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.3 million. This is based on the assumption in a recent study[759] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, 14 Member States[760] would have to introduce a requirement for a suitability assessment (NB. this is based on the assumption that 13 Member States[761] have a legal requirement for creditors to provide risk warnings).

– Annual recurring costs of EUR 0.3–1 million. These based on the assumption that it takes between 1 and 3 hours to monitor and enforce these rules.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

According to an external cost benefit analysis[762], the total costs for regulators would be EUR 0.54 million. This is based on the following assumptions.

[757] See footnote 625.
[758] See footnote 746.
[759] See footnote 136.
[760] See footnote 748.
[761] See footnote 625.
[762] See footnote 136.

– The figure is a NPV of regulator costs over a 15-year period from 2009 to 2014.

– The one-off and annual recurring costs are based on the results of a questionnaire to regulators. As relatively few quantitative responses were received, the highest figures received are applied to all countries to generate an upper bound of the likely cost. For this policy option, one-off costs are estimated at EUR 23 529 and annual recurring costs are estimated at EUR 0. Annual cost estimates were discounted using a real interest rate of 4 %.

4.9.2.4. Option 2.4: Requirement for the borrower to provide correct information on his/her situation

As explained in the description of the Options, the implications of this option have been analysed when discussing the impacts of Option 1.6.

4.9.2.5. Option 2.5: Specific product regulation including bans or caps on certain credit products

Effectiveness of policy option

Specific product regulation would address the problem of risky products directly by intervention in the market. The effectiveness of such interventions in terms of ensuring suitability and preventing consumer detriment is however highly debatable. Mortgage products are highly individualised products and it is unlikely that 'one-size-fits-all' approaches would be an effective tool. Moreover, no hard evidence can currently be found supporting the implementation of some product regulation rules, such as Loan to Value (LTV) or Loan to Income (LTI) limits.[763]

A product that has attracted regulators attention is mortgage credits in foreign currency. These are quite spread in a number of Member States, such as Bulgaria, Hungary, Poland, Lithuania, Estonia, Romania or Latvia (please see Graph 18 in Annex 2). Plans to ban this type of mortgage credits exist. Hungary for example has adopted measures in August 2010 prohibiting the creation and registration of new mortgages securing foreign currency loans provided to natural persons[764]. While this would seem effective in protecting consumers from adverse exchange rate movements, it may have consequences that would outweigh the consumer protection benefits. First, such measures could be an obstacle to the free movement of capital and curtail the benefits this brings about to the internal market. Second, some consumers, such as those with an income stream in the foreign currency, may be willing to assume the risk and benefit from the advantages offered by those credits. Information on the risks of that credit product, e.g. an obligation to include the corresponding warnings in the ESIS, would then be a more proportional way of achieving the same result (consumer protection).

763 For example, see footnote 246.

764 Chapter VI of the Act XC of 2010 on the Creation and Amendment of certain Acts concerning Economic and Financial Matters amends the Hungarian Civil Code with its implementing measures (Act IV of 1959 on the Civil Code and the Law-Decree 11 of 1960 on the Entering into Force and the Implementation of the Civil Code) and the Act on the Property Registry (Act CXLI of 1997 on the Property Registry), with a view to prohibiting the creation and registration of new mortgages securing loans denominated or provided in a foreign currency provided to natural persons (excluding individual entrepreneurs). The provisions entered into force on 14 August 2010.

Some Member States such as Austria or Poland for example ban high LTV mortgages. The rationale in these countries for prohibiting high LTV mortgages generally relates to limiting credit growth, stabilising volatile property markets and enhancing financial stability. These are prudential issues that are beyond the scope of the responsible lending and borrowing initiative. There are currently other initiatives such as the CRD amendments that will also address the prudential issues mentioned.[765] Whatever the chosen product restrictions, this option would hinder the achievement of the objective of tackling barriers to cross-border mobility as regulation limiting the product set, unless identical in all Member States, is very likely to reinforce market entry barriers and hence act as an obstacle to cross-border mobility. They would also substantially reduce product diversity and thus consumer choice. Specific rules for products are also likely to distort competition. Housing and mortgage markets are highly diverse. Specific product rules would favour firms and consumers in those Member States that prefer products with the regulations of specific designed rules and hence skewing the playing field towards them. A potential outcome is that 'structuring' activities of loans would take place, trying to circumvent specific product rules.

Impacts of policy option on stakeholders and efficiency

The costs and benefits of such a strong interference into market force depends highly on the type of practice that is targeted, whether it indeed ranks high on some rather objective risk scale, or whether it is banned rather for the protection of the domestic product set or industry, and whether there is a viable alternative to consumers.[766]

Creditors will face one-off costs of EUR 71 million and credit intermediaries will face one-off costs of EUR 11 million for redesigning their product range and making the necessary systems changes. Annual recurring costs for creditors and credit intermediaries would be zero as once the products were removed from the product range no further action would be required. Creditors and consumers could potentially benefit from a reduced credit risk. However, other policy tools such as creditworthiness assessments or prudential requirements are probably more effective to address issues of credit risk and financial stability. As a recent study pointed out, the indirect effect on the product set brought about by a proper assessment of consumer's creditworthiness is less costly than a direct intervention into the market.[767]

Considering the above arguments concerning the effectiveness of this measure, its impact on the number of defaults is considered to be lower than other policy options in terms of the impact on basis points, however because it would impact on all 27 Member States rather than only a proportion of them, the overall impact would be greater. Thus, benefits of would be EUR 747–996 million for the EU27. Imposing specific rules would mean that a 'one-size-fits-all' approach would be applied to resolve issues related to creditworthiness and suitability. Such a policy risks to reduce, not only the range of products available to consumers but also their access to credit. Thus, despite the above gains from a reduction of the default rate, the net impact regarding consumer welfare is therefore likely to be negative.

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[765] Further information on those possible changes to the CRD available at http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm.

[766] See footnote 136.

[767] See footnote 136.

Quantification of costs and benefits

Consumers and society in general will face aggregate benefits of EUR 747–996 million. This reflects the value of the reduction in the number of defaults. This can be broken down as follows.

– This is based on the assumption that the average EU default rate for mortgage loans, which is about 1.4 %, could be reduced by 6–8 basis points due to the provision of information by borrowers.

– This is equivalent to mortgages of EUR 747–996 million.[768]

Creditors will face one-off costs of EUR 71 million and annual recurring costs of EUR 0. Credit intermediaries will face one-off costs of EUR 11 million and annual recurring costs of EUR 0. These costs can be broken down as follows.

– One-off costs for creditors will amount to approximately EUR 71 million. This is based on the assumption that each institution must provide 8 hours training to 20 % of its staff. One-off costs for credit intermediaries will amount to approximately EUR 11 million. This is based on the assumption that each credit intermediary must provide 8 hours training to 80 % of its staff. It is also based on the assumption that no changes are required to IT systems and Standard Operating Procedures.

– Incremental annual recurring costs for creditors and credit intermediaries are estimated at EUR 0. These based on the assumption that certain products would be forbidden and thus not available on the market. Once these products were removed from the product range, no compliance costs would be necessary.

According to Commission services' estimates Member States will face EUR 0.6 million in one-off costs and no annual recurring costs. These costs can be broken down as follows.

– One-off costs of EUR 0.6 million. This is based on the assumption in a recent study[769] that each Member State will incur one-off costs of approximately EUR 23 529. In this instance, all 27 Member States would have to introduce product restrictions.

– Annual recurring costs of EUR 0. These based on the assumption that certain products would be forbidden and thus not available on the market. Consequently, no monitoring or enforcement would be necessary.

Benefits are also expected on Member States' side. Reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These benefits are however not quantifiable.

768 See footnote 277.
769 See footnote 136.

4.9.3. Comparison of options

4.9.3.1. Creditworthiness assessments

The 'Do nothing' option would not address the problems identified. This option should therefore be rejected.

Table 31: Creditworthiness – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure that creditors and borrowers take appropriate lending and borrowing decisions	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1.1: Do nothing	0	0	0	0	0	0	0
1.2: Requirement for the creditor to assess the borrower's creditworthiness	✓✓	✓✓	✓	✓	✓	✓✓	✓✓
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	✓✓✓	✓✓✓	✓	✓	✓	✓✓✓	✓✓
1.4: Non-discriminatory access to databases for creditors	✓	0	✓	✓✓	✓✓	✓	✓✓
1.5: Homogenise the content and characteristics of data bases	✓	0	✓	✓	✓✓	✓	✓
1.6: Requirement for the borrower to provide correct information on his/her situation	✓	0	×	✓✓	✓	✓	✓

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Option 1.2 would introduce an obligation to assess the creditworthiness of a consumer seeking to take out a mortgage. Although this policy option has been found to be highly operational and effective in tackling various responsible lending and borrowing issues, Option 1.3 (denial of the credit in case of negative creditworthiness assessment) achieves to a greater extend the objectives identified. This is primarily due to the fact that the assessment incorporates the cost and benefits of Option 1.2 as it is not feasible to deny credit without first undertaking a creditworthiness assessment. The positive effects of Option 1.3 would be however reinforced if combined with Option 1.4 (access to databases), Option 1.5 (homogenisation of databases) and Option 1.6 (borrower disclosure obligations), which should have an positive impact with regards to the specific objective (appropriate lending decisions) but also on cross-border activity. This is due to the fact that these options broaden the scope of information upon which creditors, including foreign ones, conduct a creditworthiness assessment. Access to databases and/or to correct information from the borrower will also reduce the competitive disadvantage of creditors with no previous relation with the borrower in comparison to those creditors who can rely on internal sources of information on the borrower. It needs to be noted however that, as explained before, doubts on the feasibility, at least in the short term, of Option 1.5 remain due to the difficulty to agree on the standards for data content and data registration to be applied across the EU.

Table 32: Creditworthiness – Impact on main stakeholders

Stakeholders/ Policy options on product creditworthiness	Consumers	Creditors	Member States
1.1: Do nothing	0	0	0
1.2: Requirement for the creditor to assess the borrower's creditworthiness	✓✓	✓	0/×
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	✓✓✓	✓	0/×
1.4: Non-discriminatory access to databases for creditors	✓/0	✓✓	0/×
1.5: Homogenise the content and characteristics of databases	✓✓	✓✓	0
1.6: Requirement for the borrower to provide correct information on his/her situation	✓/0	✓✓	0/×

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

An obligation to perform creditworthiness checks for mortgage credit (Option 1.2) is expected to bring about relatively high benefits for consumers and society while the implementation costs for creditors are estimated to be reasonable. Greater gains, in terms of a reduction of the default rate, can however be attained if creditors are required to deny the credit in case of a negative creditworthiness assessment (Option 1.3). Nevertheless, an obligation to base loan granting decisions on the assessment of the ability to repay of the borrower will be ineffective if the information needed to perform the assessment is not available. That is why the preferred option is a combination of the Options 1.3 (requirement to deny credit), 1.4 (access to databases) and 1.6 (borrower disclosure). Although also beneficial in principle, more discussion among stakeholders seems needed before Option 1.5 would be feasible and therefore effective. For all policy options, Member States will face costs for introducing rules (in the event of a legislative instrument). The benefits for society (more sustainable markets) are already incorporated into the benefits for consumers in terms of default.

Table 33: Creditworthiness – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 1.1	Option 1.2	Option 1.3 (incorporating Option 1.2)	Option 1.4	Option 1.5	Option 1.6
Consumer/social benefits reduction in defaults(value of mortgages)[770] increased mobility and competition	0 0	124–187 Not quantifiable	187–249 Not quantifiable	123–205 Not quantifiable	311–436 Not quantifiable	60–120 0
Creditor/credit intermediary benefits: increased opportunities	0	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable
Total EU costs (million EUR)	Option 1.1	Option 1.2	Option 1.3	Option 1.4	Option 1.5	Option 1.6
Consumer costs: reduced access to credit	0	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable
Creditor costs: one-off recurring	0 0	104 11	104 11	Not quantifiable	0 0	34 67–112
Credit register costs: one-off (direct) one-off (indirect) recurring (direct) recurring (indirect)	0	0	0	0.2–0.3 0.1–0.2 0.1–0.2 0.1–0.2	3 3	0
Member State costs: one-off recurring	0 0	0.09 0.2–0.3	0.4 0.2–0.3	0.2 0	0.6 0	0.4 0
Net costs and benefits (NPV over 15 years)	**0**	**10.53**	**10.53**	**0–115**	**Not available**	**0**

4.9.3.2. Suitability assessments

The 'Do nothing' option would not address the problems identified. This option should therefore be rejected.

770 See footnote 281.

Table 34: Suitability – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure that creditors and borrowers take appropriate lending and borrowing decisions	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered	✓✓	✓	✓	✓✓	✓✓	✓✓	✓✓
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	✓✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
2.4: Requirement for the borrower to provide correct information on his/her situation	✓	0	×	✓✓	0	✓	✓
2.5: Specific product regulation including bans or caps on certain credit products	0	✓	0	××	×	0	0

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Option 2.1 has proven not only to be ineffective but also damaging in the long run for consumers, creditors and the economy as a whole. Introducing an obligation to systematically assess the suitability of the credit products offered to the consumer (Option 2.2) would address some of the negative consequences of responsible lending a borrowing and bring about gains to both consumers and creditors. However, this option will be more effective if coupled with a requirement to warn borrowers when a particular credit product appears unsuitable to the borrower's needs and circumstances (i.e. Option 2.3 which combines the suitability assessment with a warning to borrowers). Option 2.4 has proven to have a positive impact while not imposing significant costs on the different stakeholders. Option 2.5, on the other hand, has proven ineffective, in particular because of the potential negative effects on, among others, the extent of the product offer, innovation or lending volumes that this option would entail. The preferred option is therefore a combination of Options 2.3, which combines the suitability assessment with a warning to borrowers, and 2.4, a requirement for borrowers to disclose information.

Table 35: Suitability – Impact on main stakeholders

Stakeholders/ Policy options on product suitability	Consumers	Creditors	Credit intermediaries	Member States
1: Do nothing	0	0	0	0
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered	✓✓	✓	✗	✓
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	✓	✓	✗	✓
2.4: Requirement for the borrower to provide correct information on his/her situation	0	✓✓	0	✓
2.5: Specific product regulation including bans or caps on certain credit products	0 / ✓	✗✗	✗✗	0

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
✗✗✗ (Strong) – ✗✗ (Moderate) – ✗ (Weak) negative contribution – 0 neutral contribution

Under Option 2.1, a continuation of all the identified problems in relation to suitability is expected. Only a requirement to assess the credit product suitability (Option 2.2) could address those. However, greater benefits for both consumers and creditors would result from an implementation of Option 2.3 which incorporates Option 2.2 coupled with a warning. Its positive effects could be reinforced if combined with the obligation for the borrower to provide correct information (Option 2.4). Option 2.5, despite the potential benefits has been rejected because of the risks of not only introducing important distortions into the market but also imply high costs for the mortgage credit industry as well as the potential impact in terms of reduced access to credit and limited product diversity. Thus, the preferred option is a combination of Options 2.3 and 2.4.

Table 36: Suitability – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 2.1	Option 2.2	Option 2.3 (incorporating Option 2.2)	Option 2.4	Option 2.5
Consumer/social benefits: reduction in defaults(value of mortgages)[771] increased confidence and mobility	0 0	383–493 Not quantifiable	442–553 Not quantifiable	See Option 1.6 above	747–99 Not quantifiable
Creditor/credit intermediary benefits: business opportunities	0	Not quantifiable	Not quantifiable	See Option 1.6 above	0
Total EU costs (million EUR)	Option 2.1	Option 2.2	Option 2.3	Option 2.4	Option 2.5
Consumer costs: reduced access to credit reduced product diversity	0	Not quantifiable	Not quantifiable	Not quantifiable	Not quantifiable
Creditor/credit intermediary costs: one-off recurring	0 0	337 82	337 82	See Option 1.6 above	71 0
Member State costs: one-off recurring	0 0	0.3 0.3–1	0.3 0.3–1	See Option 1.6 above	0.6 0
Net costs and benefits (NPV over 15 years)	0	Not available	0.54	See Option 1.6 above	Not available

4.10. Assessment of policy instruments

4.10.1. Self-regulation

The preferred policy options for creditworthiness and suitability could all be pursued through the use of self-regulation in theory. However in practice, several aspects would limit the effectiveness and efficiency of self-regulation.

First, a stated benefit of self-regulation is that it is flexible and may be easily modified to take into account market developments. Experience has shown though that reaching agreement between the different stakeholders, in particular consumers and industry representatives, is extremely difficult. Negotiations are long, and resource consuming, due to the large divergence of opinions between the two parties. Given their shortage of resources, this problem is particularly acute for consumer representatives. Second, for self-regulation to be successful, adherence and implementation of the agreed Code of Conduct must be high, near the 100 % level that exists in the case of binding legislation. Given the experience with the adherence and implementation of the *Voluntary Code of Conduct on Pre-Contractual Information for Home Loans*, it is unlikely that such adherence and implementation levels are reachable. This is because some providers may refrain from signing a Code, while others may be unable to do so for fear of contravening national legislation, and others may sign but inadequately apply it. Finally, while some of the policy options can in theory be achieved

771 See footnote 281.

through self-regulation, the fact that they are already regulated by law in some or all Member States means that self-regulation would be ineffective, e.g. for the APRC, or lead to a duel burden on creditors, e.g. two sets of information sheets to be provided – one under national rules and one under EU rules. These deficiencies neutralise the benefits of self-regulation. It is therefore unlikely that self-regulation will be an effective instrument in the achievement of the objectives.

4.10.2. Non-binding measures: Commission Recommendation

A Recommendation to Member States could in theory give effect to all the policy options. However, some Member States are likely to refrain from implementing the recommendation into national law while others may be prevented by the existence of contravening national provisions and be reluctant to amend and/or abolish existing national provisions. It therefore follows that implementation is unlikely to reach at or near the 100 % level. This will result in a somewhat partial achievement of the objectives pursued under this initiative, with the extent of success largely dependent on how many Member States would decide to implement the Recommendation.

4.10.3. Binding measures: Directive or Regulation

The introduction of a Directive or Regulation has been identified as the most effective and efficient way of achieving the abovementioned objectives for all policy options.

Only a binding Community instrument can guarantee that preferred policy options are introduced throughout all 27 EU Member States, and that those rules are adequately enforced through regulatory oversight and dissuasive sanctions for non-compliance. A degree of flexibility can also be introduced by considering the use of technical or implementing measures.

A binding instrument would bring benefits to creditors, credit intermediaries and consumers alike. It would ensure that a level playing field was created throughout the EU, minimising costs and maximising the scope for economies of scale for creditors and credit intermediaries seeking to operate cross-border. It would also ensure that the benefits to consumers were maximised at the upper ends of the ranges mentioned in Table 36. At the same time, adopting binding legislation is time consuming and costly. Member State administrations will incur costs (see also Table 36) for designing, implementing, transposing (in case of a Directive) and enforcing legislation. Creditors and credit intermediaries would also face one-off and recurring implementation costs however these would be the similar under self-regulation and/or non-binding measures.

In general, the Commission has the choice between a Directive and a Regulation as a binding policy instrument. A Directive has, on the one hand, the advantage of allowing for a more flexible approach, enabling both minimum and maximum harmonisation within the same instrument and thus is able to take into account the specificities of national markets. A minimum harmonisation Directive would allow more flexibility to Member States than a maximum harmonisation Directive, which would reduce the possibilities for Member States to gold plate. A Regulation, on the other hand, theoretically allows achieving the highest level of harmonisation and standardisation in a shorter timeframe without the need for national transposition measures. It also enable private enforcement by consumers and business alike, thus bringing the single market closer to the citizen.

While a Directive approach with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national specificities of the market. A Directive could also, in theory, ensure maximum harmonisation in certain areas, while enabling minimum harmonisation in others. Such an approach would provide a degree of flexibility. It is therefore recommended to use the legal instrument of a Directive.

4.11. Impact on Community resources and other impacts and impacts on third countries

The recommended set of policy options on product suitability does not have any impact on European Community resources.

Positive social impacts can be expected by the various policy proposals on creditworthiness and suitability. Compulsory creditworthiness and suitability assessments, as well as enhanced access to information on the borrower will dramatically reduce irresponsible lending and borrowing decisions and therefore contribute to a reduction of the default rate and the number of foreclosures. Negative social impacts are possible since several policy proposals could potentially limit the access to mortgage credit for some categories of borrowers (in particular the most vulnerable such as those on low incomes). The consequences of this will not be significant if those consumers are offered other housing alternatives (e.g. low rent dwellings or social housing).

No impact on the environment can be expected from the policy proposals in the creditworthiness and suitability area.

With regard to the impact on third countries, the introduction of rules on creditworthiness and suitability assessments will not lead to discrimination against creditors or credit intermediaries from third countries willing to offer their services on the EU territory as they would need to comply with the same rules. If the proposed Directive is extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway. Finally, no direct impact on other countries is to be expected.

4.12. Conclusion

The introduction of a requirement for suitability and creditworthiness assessments to be conducted ahead of the conclusion of a credit agreement is expected to address effectively the problems identified and generate positive impacts on the European mortgage market. The proposed set of policy options including requirements for creditworthiness checks and suitability assessments as well as non-discriminatory access to databases for creditors and rules for borrower disclosure will address effectively a wide range of irresponsible lending and borrowing practices and lead to further integration of the European mortgage market. A framework of high consumer protection standards and sound underwriting decisions by mortgage providers will reduce default on mortgage loans, prevent overindebtedness and its adverse impacts on society and the wider economy and provide for a sustainable financial system with healthy and prudent creditors. Non-binding regulations would always leave space for irresponsible lending and borrowing practices. Creditors and borrowers may even have strong incentives to deviate from good practices for their own benefit. Binding rules are therefore preferable. It is recommended to implement the proposed policies by means of a

Directive as it would leave Member States some flexibility to accommodate the particular circumstances of their housing and mortgage markets.

5. REGISTRATION, AUTHORISATION AND SUPERVISION OF CREDIT INTERMEDIARIES

5.1. Context

Consumer demand for credit and the increasing variety and complexity of credit products in recent years have led to a business opportunity for credit intermediation, whereby one agent acts as a contact point between the borrower and one or more lenders.

Credit intermediaries play an important role in mortgage and consumer credit markets. They perform market searches and are involved in 'market matching', i.e. bringing together consumers and suppliers of credit. Their presence in the market can deliver benefits for consumers as they can create transparency in the wide variety of players and their products available. In addition, they can provide 'tailor-made' information on products. Credit intermediaries often go beyond the provision of information on products and actively provide advice.

Furthermore, credit intermediaries could be an important vehicle in enhancing the circulation of financial services in the internal market for lenders. They can facilitate market access for lenders who seek to enter a new market without the need to establish presence in the market itself. Finally, credit intermediaries can also play a role in facilitating the conclusion of credit agreements through the performance of administrative tasks or can be involved in the assessment of the suitability of a credit product for a borrower.

Member States within the EU27 have different definitions of 'credit intermediaries' and apply them to different types of business. For the purpose of this impact assessment, a broad definition of a credit intermediary is used: a credit intermediary is an individual or firm that does not provide credit itself but rather acts as a third-party and facilitator between an individual obtaining access to credit and a credit provider.

It should be noted that there might be a chain of intermediate parties between the ultimate borrower and the credit provider. In some specific cases this includes agents who resell products from credit intermediaries. Furthermore, a distinction is made between tied and untied intermediaries. Credit intermediaries that offer only the products of one or more lenders/credit providers are known as tied intermediaries. Those credit intermediaries that operate independently are untied intermediaries.

5.2. Overview of the legislative framework

5.2.1. EU level

Credit intermediaries *per se* are not subject to EU regulation. However, the CCD regulates certain aspects of consumer credit intermediation, for consumer credit agreements between EUR 200 and EUR 75 000.[772] Mortgage credit is therefore not addressed at the EU level. In

[772] See footnote 254, Articles 2 and 3(c).

contrast, investment and insurance intermediation which are regulated by the Insurance Mediation Directive[773] and the Markets in Financial Instruments Directive[774] respectively.[775]

The term 'credit intermediary' has been defined at EU level in the CCD[776] as "a natural or a legal person who is not acting as a creditor and who, in the course of his trade, business of profession, for a fee, which may take a pecuniary form or any other form of financial consideration (i) presents or offers credit agreements to consumers; (ii) assists consumers by undertaking preparatory work in respect of credit agreements other than referred to in (i); or (iii) concludes credit agreements with consumers on behalf of the creditor"[777]. The CCD also covers some credit intermediary activities particularly with regard to advertising, information provision and conduct of business. The prudential supervision aspects of credit intermediaries are not regulated by the CCD.

Intermediation in the insurance and investment sector is regulated by the Insurance Mediation Directive (IMD)[778] and Market in Financial Instruments Directive (MiFID)[779] respectively. The IMD makes a clear distinction between tied and untied insurance intermediaries[780]: the credit intermediary category can thus also be broken down between tied (agent) and independent (broker) intermediaries according to existing EU legislation regarding intermediation. A tied insurance intermediary is defined as: "any person who carries on an activity of insurance intermediation for and on behalf of an insurance undertaking and under the full responsibility of that undertaking (…)". The Insurance Mediation Directive also provides for a 'negative definition' of intermediaries as it excludes:

– persons with another professional activity and who provide advice on an incidental basis in the course of the other professional activity[781], and

– persons who practice mediation as an ancillary activity under strict conditions[782].

Given that many intermediaries also intermediate in other financial products of the financial sector[783] such as insurance and investment products, they may be subject to MiFID and the IMD for the intermediation of these products, but not for credit[784]. This is not only with regard to information disclosure and selling practices but also for registration, authorisation and supervision.

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773 Directive 2002/92/EC.

774 Directive 2004/39/EC, Article 5.

775 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

776 See footnote 254.

777 See footnote 254, Article 3(f).

778 Directive 2002/92/EC.

779 Directive 2006/31/EC.

780 Directive 2002/92/EC, Article 2(7).

781 Directive 2002/92/EC, Recital 13.

782 Directive 2002/92/EC, Recital 14.

783 See footnote 6.

784 *Summary of Responses to the Public Consultation on Responsible Lending and Borrowing*, European Commission, 2009. The Belgian Federal Ministry of Economy acknowledges that there are that multi-product intermediaries (i.e. those involved in the intermediation of insurance and investment products as well as credit) who are subject to different regulatory regimes such as the Markets in Financial Instruments Directive (MiFID) and the Insurance Mediation Directive (IMD).

5.2.2. *Member State level*

In parallel, at Member State level there are considerable divergences in the level and applicability of regulation in place[785]. Out of 27 Member States, 23 have introduced national legislation applicable to credit intermediaries leading to considerable divergences in the extent, the nature and scope of credit intermediation regulation between Member States.[786] This divergence is further intensified by the fact that even within individual Member States, there are differences in the level of regulation applicable to different credit products.

Credit intermediaries are defined and categorised differently in the various Member States, with, in certain cases different regulations applying to different categories such as brokers, agents, financial consultants, mortgage credit intermediaries and consumer credit intermediaries.

Credit intermediaries are specifically defined in only eight of the 27 Member States (Austria, Belgium, Denmark, Estonia, Ireland, Malta, the Netherlands).[787] In twelve Member States (Bulgaria, Czech Republic, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Romania, Slovenia, Slovakia) there are general definitions of intermediation which is not specified but to a certain extent applicable to credit intermediaries.[788] Seven Member States (Cyprus, Lithuania, Luxembourg, Poland, Spain, Sweden, UK) do not have a legal definition at all.[789]

Table 37: Definitions of credit intermediaries

Country	Definitions
Austria	Definition of 'credit intermediary' in Austrian broker act: a credit intermediary "is someone who commercially conveys credit – as defined by the Austrian Banking Act".
Belgium	Definition of 'credit intermediary' in law: "any person who aids in the conclusion or execution of a credit contract within the framework of his or her commercial or professional activities".
Bulgaria	General definition of 'financial brokerage': includes contract intermediation for credit, managing credit on behalf of the client, providing credit consultations, consulting firms regarding credit operations, general financial advice as relevant to credit intermediation. It excludes direct credit lending.
Cyprus	No definition of 'credit intermediary'.
Czech Republic	No definition of 'credit intermediary'. General definition of trade and services intermediation. Two groups of intermediaries are identified: ones operating on the market that combine consulting with an offer of financial products for which remuneration is paid in the form of a brokerage fee for intermediated products and the client pays no direct payment (these ones are non-exclusive or untied); ones that are exclusive (tied) representatives who are either subsidiaries of a financial institution or a direct sales network with direct contractual links to a financial institution.
Denmark	Description of 'credit intermediary': "a company or a person who offers to arrange for a consumer the provision of credit or the letting of goods in return for a commission from the provider of the credit".
Estonia	General description of 'credit intermediary'. "Credit broker is a person who undertakes to arrange, for a charge, for credit to be granted to consumers in the course of the economic or professional activities of the credit broker, or to indicate the possibility to enter into a credit contract".
Finland	No definition of 'credit intermediary'. General definition of the role of third parties.
France	General definition of 'banking intermediaries': "any person who, on the basis of their usual profession, acts as an intermediary between parties that are interested in concluding a banking operation without any del credere guarantee". They are natural persons or legal entities mandated by banks or credit agencies.
Germany	No definition of 'credit intermediary'. General definition of *finanzdienstleistungsinstitute* who provide personal recommendations concerning commercial operations with certain financial instruments to consumers or their representatives, management of finance instruments for third parties. Credit intermediaries do not grant credit themselves.

785 See footnote 6.
786 All except Cyprus, Latvia, Lithuania and Luxembourg. See footnote 6.
787 See footnote 6.
788 See footnote 6.
789 See footnote 6.

Greece	No definition of 'credit intermediary'. Legislation differentiates credit intermediaries from 'connected representatives'. Credit intermediaries inform the public about credit products, inform debtors about their repayment of their liabilities, they may receive a fee from the client. A 'connected representative' advertises investment services, receives and conveys investment instructions, advises customers in relation to the services supplied by the credit institution.
Hungary	General definition of intermediation of financial services': activities pursed in order to facilitate a financial institution's financial services without involvement in the handling of the customer's money or assets. There are 2 types of intermediary: one who works on behalf of the institution (the risks and responsibility remain with the financial institution but entity can make a contract with the borrower for commission from the financial institution) and one who helps the credit business to be realised.
Ireland	Description of 'credit intermediary': "a person other than a credit institution or a mortgage lender, who in the course of his business arranges or offers to arrange for a consumer the provision of credit or the letting of goods in return for a commission, payment or consideration of any kind from the provider of the credit or owner".
Italy	No definition of 'credit intermediary'. General definition of intermediation: distinction drawn between credit brokers who are independent and do not act in the interests of either party and financial agents that operate in the interest of one or more credit providers.
Latvia	No definition of 'credit intermediary'. General definition of broker as a business institution that performs an intermediary agency transaction for third parties without being involved in a contractual commitment with any of these parties.
Lithuania	No definition of 'credit intermediary'.
Luxembourg	No definition of 'credit intermediary'.
Malta	Definition of 'credit intermediary' as persons who intermediate and offer their services to customers wishing to access credit facilities. They are a subset of money brokers.
Netherlands	Definition of 'credit intermediary' as all activities carried out in the course of a profession or business focused on concluding, as a middleman, a contract regarding credit between a consumer and a lender or on assisting in the administration and performance of such a contract. Money brokers are seen as independent but there is a reference to tied brokers who are a licensed institution acting as an agent for connected or other undertakings, and not dealing in the capacity of a money broker on a stand alone basis.
Poland	No definition of 'credit intermediary'.
Portugal	No definition of 'credit intermediary'. Regulation of 'promotores' who are individuals tied to one credit institution (or group) that facilitate access to the activities reserved to that credit institution or financial company.
Romania	No definition of 'credit intermediary' for mortgage lending. For consumer credit an intermediary is defined as any natural or legal person that in exchange for a fee acts as an intermediary by presenting or offering credit agreements or by performing other works in preparation of such agreements.
Slovakia	Under a law due to enter into force in 2009, a credit intermediary is a financial intermediary. General definition of financial intermediary: it provides services to an extent depending on his/her qualifications and has a contract with one or more financial institutions. Under this law there will be a distinction between an intermediary (agent) who provides services to an extent depending on qualifications and has a contract with one or more financial institutions and a financial consultant who provides services based on a contract with a client.
Slovenia	No definition of 'credit intermediary'. General definition of intermediaries: two types are defined. Tied intermediaries who work for a bank, defined as a natural or legal person, who within the framework of their activities, business or profession mediates in the conclusion of credit contracts for a bank/savings bank which has permission to provide consumer credits; untied intermediaries, defined as a natural or legal person, who within the framework of their activities, business or profession mediates in the conclusion of credit contracts within the framework of the activities of the creditor.
Spain	No definition of 'credit intermediary'. Definition of an agent of credit institutions who is a third party to which the institution has granted powers of attorney so that they may act on its behalf in the negotiation or conclusion of operations that are typical of the business of credit institutions. An agent may only represent one credit institution or one consolidated group of credit institution.
Sweden	No definition of 'credit intermediary'.
United Kingdom	No definition of 'credit intermediary'. But legislation specifies the activities for which a firm needs to be regulated, include advising on or arranging a regulated mortgage as defined in the Financial Services and Markets Act 2000.

Source: Europe Economics, January 2009.

Not all Member States require credit intermediaries to be registered with a competent authority or to be authorised (at least for the specific activity of credit intermediation). Nine Member States (Belgium, Finland, Greece, Hungary, Italy, Poland, Spain, Slovakia, Sweden) require that credit intermediaries are registered; five (Germany, Malta, the Netherlands, Romania, the United Kingdom) have a licensing regime; two (Ireland and the Netherlands) require authorisation.[790] The extent and the nature of these requirements differ considerably between Member States.

Moreover, there are generally no requirements for credit intermediaries to have undertaken specific training, to have obtained any given academic level of education, or to have completed any professional training in the majority of EU Member States. Only14 Member States (Austria, Bulgaria, Czech Republic, France, Germany, Greece, Hungary, Ireland, Italy, Malta, the Netherlands, Poland, Slovenia and the United Kingdom) require credit intermediaries to have minimum professional qualifications[791]. These could encompass physical requirements (such as a fixed address) or legal requirements (citizenship, age, or an authorisation). However, the set of minimum standards are seldom specified and vary across Members States. For the entry qualifications or standards that are applicable the level of any vocational qualification is also seldom indicated[792].

Some Member States[793] have put in place prudential requirements for credit intermediaries for offering mortgage credit, in order to ensure that borrowers can have confidence in the safety of their transaction with credit intermediaries. In the United Kingdom[794], the Netherlands[795] and Austria, mortgage intermediaries are required to take out professional indemnity insurance.[796] In the United Kingdom the minimum amount of the insurance is set on an annual basis and shall cover only a period of one year. In the Netherlands a defined level of insurance is required for mortgage and consumer credit intermediaries. In Austria, this is limited to mortgage intermediaries. Another form of prudential standards is a requirement for minimum capital. Capital adequacy requirements are present in Bulgaria, Germany, Malta and the United Kingdom.[797] In Bulgaria this requirement applies to consumer credit intermediaries only, in Malta to intermediaries in business finance, and in the United Kingdom to mortgage intermediaries. In Germany the required minimum start up capital is EUR 125 000. Other prudential standards could concern a sound business plan to bring credit intermediaries in line with credit institutions, the lenders or comply with money laundering legislation, as is the case in Bulgaria[798].

The information in the table below illustrates more specifically the situation concerning the entry requirements and supervision of credit intermediaries in the 27 Member States.

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790 See footnote 6.

791 Belgium, Bulgaria, Czech Republic, Germany, Ireland, Greece, France, Italy, Hungary, Malta, the Netherlands, Austria, Poland, Portugal, Slovenia, Slovakia, Finland, Sweden and the United Kingdom. See footnote 6.

792 For information: in 2005 ISO issued ISO 22222 on personal financial planning setting out requirements for personal financial planners. The International Standard specifies the ethical behaviour, competences and experiences required of a professional personal financial planner. It also describes conformity assessments regarding knowledge, skills and experience.

793 Germany, Malta, the Netherlands, Austria, Bulgaria and the United Kingdom.

794 The minimum amount of the insurance is set on an annual basis and covers only a period of one year.

795 A defined level of insurance is required for mortgage and consumer credit intermediaries.

796 See footnote 6.

797 See footnote 6.

798 This patchwork of prudential requirements for credit intermediaries in Member State legislation contrasts with requirements for professional indemnity insurance set out in the Insurance Mediation Directive. Article 4(3) of Directive 2002/92/EC, which stipulates that insurance intermediaries shall hold professional indemnity insurance (…) or some other comparable guarantee against liability arising from professional negligence, for at least EUR 1 000 000 applying to each claim and in aggregate EUR 1 500 000 per year for all claims. For tied intermediaries such insurance can be provided by the undertaking for and on behalf of whom the intermediary works.

Table 38: Overview of the rules covering the registration, authorisation and supervision

Country	Legal, judicial, or self-regulatory rules regarding registration, authorisation and supervision of credit intermediaries
Austria	No specific statutory rules for registration, licensing or supervision. The activity of credit intermediation is part of the role of a 'financial consultant', which requires a comprehensive qualification. Minimum standards/qualifications are needed to begin acting as an intermediary.
Belgium	Persons who exercise credit intermediary activities must register with the Ministry of Economic Affairs. An intermediary advising on mortgages would be supervised according to product and marketing (i.e. advertising) rules by the Commission Bancaire; Financière et des Assurances.
Bulgaria	The Bulgarian Law of Credit Institutions does not explicitly regulate credit intermediaries, their market entry or ongoing activity. They are considered part of the financial brokerage system. As such they and are not subject to licensing by the Bulgarian National Bank (BNB) and are not required to pass the Bulgarian equivalent of the 'fit and proper' test. Credit intermediaries must notify BNB about the scope of intended activity within 14 days of market entry, unless it is governed by another law or license.
Cyprus	No provisions
Czech Republic	There is no particular institution which supervises activities of credit intermediaries. In general, credit intermediaries are supervised by the Trade Licensing Authorities, because their activity is considered to be a 'reportable independent trade'. 'Intermediation in trade and services' falls into the category of unqualified trade. An independent trade, intermediation of trade and services does not require proof of any professional or other qualification. Only general conditions for acquiring an intermediation licence apply.
Denmark	No specific statutory rules for registration, licensing or supervision of credit intermediaries. The main aim of the Danish Acts is the protection of consumers.
Estonia	No specific statutory rules for registration, licensing or supervision of credit intermediaries. Credit intermediaries do not require permission or a licence to operate and are not supervised by the Estonian FSA. The task of supervision is divided between the Ministry of Justice, Ministry of Economics and Communications and the Ministry of Finance.
Finland	No specific statutory rules for registration, licensing or supervision of credit intermediaries. An agent (tied intermediary) will not need a license. The agent will be considered as part of the organisation of the credit provider and will be subjected to same set of regulations. A public register of these credit intermediaries has to be kept.
France	No specific statutory rules for registration, licensing or supervision of credit intermediaries. Under French law, credit intermediaries are intermediaries in banking operations (*Intermédiaires en operations bancaires*). The intermediary must hold a mandate issued by the lender.
Germany	Credit intermediaries are not subject to supervision by BaFin. Credit intermediaries are required to be licensed.
Greece	Credit institutions and companies providing credit are responsible for the compliance of credit intermediaries and connected representatives. The Bank of Greece regulates the credit institutions (and companies providing credit) and can be considered as the supervising body of credit intermediaries only indirectly. A broker must be registered with the Register of Finance Representatives maintained with the Bank of Greece and comply with the Banking Code of Conduct. There is no requirement for a special qualification to become credit intermediary.
Hungary	The Hungarian FSA authorises the creditor to use tied intermediaries with and without responsibilities under the condition that the financial institution ensure that an intermediary abides by the laws and regulations that apply to financial services activities. In this respect the creditor is responsible for monitoring the intermediary's activities, and is liable for the latter's activities. Tied intermediaries with responsibilities need to be licensed. Tied intermediaries without responsibilities need to be registered by the financial institution with the Hungarian FSA.
Ireland	Intermediaries are regulated and supervised by the Financial regulator. A person shall not engage in the business of being a credit intermediary unless he is the holder of an authorisation granted for that purpose by the Financial Regulator, and holds a letter of appointment in writing from each undertaking for which he is an intermediary. An authorisation is valid for 12 months. A separate, although similar, authorisation is required for mortgage intermediaries. Their application to become authorised must also include: Tax Clearance Certificate, Letters of Appointment, Certificate of Incorporation or business name (where appropriate). Minimum standards/qualifications are needed to begin acting as an intermediary (not specified in legislation).
Italy	Credit intermediaries are required to enter into a register held by *Banca d'Italia* and must comply with minimum education and integrity requirements.
Latvia	No provisions.
Lithuania	No provisions.
Luxembourg	No provisions.
Malta	Credit intermediaries are required to be licensed. Intermediaries carrying out money broking activities must be specialised in their knowledge of relevant financial product and undergo a 'fit and proper' test. They are supervised by the Maltese FSA.
Netherlands	Credit intermediaries are required to obtain authorisation and have a legal license provided by the AF. The task of the AFM is supervision of conduct. The DNB (De Nederlandsche Bank) maintains a database about all registered, licensed banks, insurers, financial businesses, pension funds, transaction and trust offices legally operating in the Netherlands. Intermediaries are subject to minimum qualifications and a 'fit and proper' test.

Poland	Limited/no provisions. According to general Polish law the only requirements for those who want to provide credit intermediary services are: being an adult and registering the company in Town Council.
Portugal	Limited/no provisions. No specific statutory rules for registration, licensing or supervision of credit intermediaries. In Portugal only the *promotores* are regulated. The *promotores* are individuals (not firms) tied to one unique credit institution (or group) that facilitate the access to the activities reserved to that credit institution or financial company.
Romania	Credit intermediaries are only regulated and supervised in relation to their business activity on consumer credit. Other types of credit intermediaries are not subject to any similar legal requirements. Steps are undertaken to implement the requirement that a credit intermediary must be licensed.
Slovakia	A new law (the Act on Financial Intermediaries and Financial Consultancy) has been prepared by the Ministry of Finance (MoF) in cooperation with the National Bank of Slovakia (NBS), which will cover the regulation of credit intermediaries and enters into force in January 2010. The new Act will require financial intermediaries and consultants to register with the NBS. The Act will also specify necessary qualifications: there will be four levels of professional competence defined, with corresponding qualifications in terms of education and years of experience prescribed.
Slovenia	Intermediaries have to act in accordance with the conditions set out by either the Bank of Slovenia (intermediaries working with banks/building societies) or the regulations of the Minister for Consumer Protection. A credit intermediary may perform intermediation services solely on the basis of the authorisation set out in a written agreement concluded with a bank. An intermediary requires an authorization within a written agreement concluded with the creditor. They are also subject to minimum qualifications and a 'fit and proper' test. The supervision of intermediaries is the responsibility of the Market Inspectorate of Republic of Slovenia, who can demand access to existing contracts regarding credit.
Spain	The new law establishes that intermediaries will be obliged to register in the public registry of the autonomous community they reside in, or in the State registry. Credit intermediaries are supervised by the Bank of Spain. There are no provisions on qualifications.
Sweden	Consumer Credit intermediaries are obliged to register for certain financial operations concerning management and qualified holders. According to the Ministry of Finance, a set standard of management ('fit and proper' test) is also required. No mentioning of supervision.
United Kingdom	The Consumer Credit Act states that such brokers as described in the definition require the same licence as other credit firms. The majority of regulation for credit intermediaries comes from the OFT. Credit intermediaries are subject to a fit and proper test. Credit intermediaries are supervised by the FSA.

Source: Europe Economics, January 2009.

5.3. Problem description

5.3.1. Registration and authorisation gaps

Registration and authorisation requirements provide the means for public authorities to control which actors are active on a market and impose conditions for the business they engage in. Such requirements are also necessary to ensure effective prudential and conduct of business supervision. Consequently, gaps in or the absence of any regulation of the registration, authorisation and supervision of credit intermediaries have the potential to create wider market or systemic failure.

Although mortgage mis-selling practices by credit intermediaries have been less prevalent in the EU than in the US[799], where widespread mis-selling contributed to the sub-prime crisis, similar regulatory and supervisory gaps, and the potential and corresponding risks of such practices exist in the EU[800]. In this respect, several regulatory gaps have been identified which have the potential to cause widespread market failure.

799 Mortgage brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 % of subprime mortgages in the United States. *The Treasury Blueprint for a modernised financial regulatory structure*, 31.3.2008. For a description of the policy measures taken in the US to reform the mortgage origination process, see http://www.treas.gov/press/releases/reports/q4progress%20update.pdf.

800 In the course of the financial turmoil and considering the role the Spanish intermediaries played in the mortgage market, the Spanish government reviewed the law and issued a more stringent regulatory and supervisory regime: http://www.bde.es/clientebanca/entidades/otros/intermediarios.htm. Furthermore the FSA indicated amidst the financial crisis that there are considerable risks and gaps in the mortgage

As described above, not all Member States require credit intermediaries to be registered with a competent authority or to be authorised (at least for the specific activity of credit intermediation), and where such requirements exist, their extent and the nature differ considerably between Member States. In those Member States where there is no requirement for the registration and authorisation of credit intermediaries, or where such requirements are particularly light, there is, as mentioned above, the potential for irresponsible behaviour. Anecdotal evidence[801] has shown that credit intermediaries often operate in small communities, including deprived urban settings and rural areas that are not served directly by lenders. Borrowers use their services because they are familiar with them as individuals. With such a 'captive clientele', credit intermediaries may not always have the incentive to ensure that they are knowledgeable about the credit products on offer, and have systems in place to ensure that the products they recommend to borrowers are best suited to the borrowers' needs. Thus the competency of the intermediary to provide a professional service cannot be assured.

The absence of any registration or authorisation requirements means that borrowers and lenders seeking an intermediary to cooperate with either domestically or cross-border cannot be confident that the intermediary they are dealing with is 'fit and proper' for the task[802].

Furthermore, in the absence of authorisation requirements, there is the danger that credit intermediaries without the necessary knowledge and competences would access the profession. This could be detrimental for both consumers (e.g. if s/he is being sold an inappropriate product) and lenders (e.g. if their image is damaged because of the lack of professionalism of the credit intermediary [reputational risk]).

A recent survey showed that cross-border activity by credit intermediaries would increase in importance as a distribution channel over the next five years, as would the level of cross-border trade.[803] 25 % of companies surveyed expressed an interest in using credit intermediaries to engage in cross-border activity.[804] However, cross-border activity is extremely limited at present.[805] This is partly due to the barriers credit intermediaries face when engaging in cross-border business: the regulatory patchwork described above can inhibit a business's decision whether to engage in cross-border business as can the different conduct of business rules. This is a sharp contrast to insurance intermediaries and investment firms who can both avail of passporting opportunities to take advantage of the single market.[806]

intermediary sector, http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2008/1112_lt.shtml.

801 Input received from the Consumer Credit Association in October 2008.

802 See footnote 51. The FSA is considering the possibilities to applying the consumer and compliance oversight functions to mortgage intermediaries that may mitigate risks to consumer protection and financial crime objectives. These include improving standards of fitness and propriety among individual mortgage advisers and prohibiting rogue individuals from the industry.

803 See footnote 6.

804 See footnote 6.

805 See footnote 6.

806 Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, Article 6 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, Article 31.

5.3.2. *Prudential and supervisory gaps*

The fact that not all Member States require credit intermediaries to be registered with a competent authority or to be authorised by them (at least for the specific activity of credit intermediation) means that there is little scope for those competent authorities to carry out any kind of supervision or inspection of the credit intermediary's activities, nor impose sanctions for misbehaviour. This has the potential to create an uncompetitive environment in which misconduct, excessive risk taking or poor advice is not held to account[807]. It may have also an impact on financial stability, as regulatory and supervisory authorities may not be in the position to asses whether credit intermediaries are involved in the provision of high-risk credit. It is widely recognised that the sales of home loans by unregulated credit intermediaries (mortgage brokers) was a significant contributing factor to the outbreak of the financial crisis in the US[808]. While the size of the market as well as the number of unregulated credit intermediaries in the EU is by no means on a comparable level to the EU, gaps in the regulatory framework do exist, thus the potential for consumer detriment and financial instability exist.

In addition, credit intermediaries' clients do not always have the right to receive redress in the event of a dispute regarding poor advice by the intermediary.[809] This creates a regulatory gap, as well as an unlevel playing field vis-à-vis mortgage lenders, and is potentially damaging to consumer confidence in using credit intermediaries.

In those jurisdictions where prudential requirements and ongoing requirements (e.g. professional indemnity insurance or own capital) for credit intermediaries are not in place, borrowers or lenders seeking to do business with an intermediary may have doubts about the integrity of those credit intermediaries. The lack of prudential standards and/or ongoing requirements for engaging in the business of credit intermediation in as many as 21 Member States can lead to an overly fluid and unreliable business as well as create an unlevel playing field vis-à-vis mortgage lenders.[810] Even in Member States with registered and supervised credit intermediaries, the regulatory framework has proved to be ineffective in some instances.[811]

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807 In recent years mortgage brokers and lenders in the US with no federal supervision originated a substantial portion of all mortgages and over 50 % of subprime mortgages in the United States. *Treasury Blueprint for a modernised financial regulatory structure*, 31.3.2008, http://www.ustreas.gov/press/releases/reports/Blueprint.pdf.

808 Henry Paulson's financial reform plan to overhaul the national regulation of the financial system addressed specifically mortgage brokers: the inadequate state standards for mortgage brokers and lenders, need to create commission to evaluate and rate state's systems for licensing and regulating mortgage brokers, see http://www.reuters.com/article/topNews/idUSWAT00911920080313?feedType=RSS&feedName=topNews.

809 Only Bulgaria, Denmark, Ireland, Malta, the Netherlands and the United Kingdom currently regulate access to formalised or streamlined systems of alternative non-court based dispute resolution (ADR) for clients of credit intermediaries.

810 The following Member States have some requirements in place: the United Kingdom (business insurance), the Netherlands (defined level of insurance), Austria (professional indemnity insurance); Bulgaria, Germany, Malta and the United Kingdom (capital adequacy requirements).

811 For example, see footnote 246.

5.3.3. *Summary of problems and consequences*

Table 39: Problems and consequences

Problem	Consequences
Registration and authorisation gaps Prudential and supervisory gaps	**Risk of consumer detriment and reduced consumer mobility** – risk of low consumer confidence in credit intermediaries => consumers purchase a product which is inappropriate for them or unnecessary => risk of inability to keep up with payments => risk of overindebtedness and foreclosure on home => reduced or restricted access to redress => reduced consumer confidence => if practices are widespread, risks for financial and economic stability **Missed opportunities for credit intermediaries** – economic and legal barriers to entering other markets => missed opportunities for cross-border business => restricted competition in the single market **Unlevel playing field between market actors** – unlevel playing field between creditors and credit intermediaries – uncertainty in or lack of confidence in the regulation of credit intermediaries, particularly those operating in another Member State => higher costs => missed opportunities for cross-border business => restricted competition in the single market

5.4. Stakeholder views

Information on stakeholder views has primarily been collected through the consultation on responsible lending and borrowing.[812]

5.4.1. *Consumers*

Consumer advocates and consumer and user representatives supported a definition of credit intermediary that would encompass all actors in the sector. They did not support differentiating between full time credit intermediaries and those offering such services on an 'ancillary' basis neither distinctions made on the basis of the product sold, with the possible exception of having a different (stricter) regime for mortgage brokers. They argued that consumers should be subject to equal protection in their dealings with all credit intermediaries, and that the consumer’s expectations of professionalism and technical knowledge on the part of the intermediary are the same.

Consumer and user representatives were also unanimously supportive of a registration and supervision regime for credit intermediaries, with professional competency requirements and professional indemnity insurance being strongly endorsed. Likewise, consumer advocates were strongly supportive of registration and supervision regimes and professional requirements for credit intermediaries, although one respondent recalled that such measures would still not address the incentive bias problem. A national consumer advisory service advocated the extension of professional competency requirements to bank client-facing staff.

812 Further information, including the feedback statement is available at: http://ec.europa.eu/internal_market/finservices-retail/credit/responsible_lending_en.htm.

With regard to whether conflicts of interest as a result of remuneration structures for credit intermediaries (and bank branch staff) could be addressed through policy, some consumer advocates and consumer and user representatives recommended abolishing commission structures altogether, and moving to a purely fee-based system, in which the borrower would pay a flat fee to receive advice on the credit transaction. A number of these stakeholders also advocated the payment of the commission over the lifetime of the loan. Many consumer advocates called for greater transparency in the disclosure of commissions, namely that they should be presented in percentage and absolute terms, and possibly in graphical form to inform the borrower.

5.4.2. Mortgage lenders

With regard to the definition of credit intermediaries and on whether distinctions should be made in the treatment of such credit intermediaries based on degree of activity (full-time basis or ancillary to their main occupation); product sold (mortgage credit / consumer credit / point of sale credit / other) or status vis-à-vis the lender (tied or independent status), the financial services industry federations and providers had a diversified opinion. Some argued for uniform regulation of all credit intermediaries and a broad application of the CCD definition of credit intermediary; others were supportive of a more tailored approach. There was broad support for a distinction between tied and independent intermediaries, particularly given the fact that tied intermediaries come under the direct responsibility of the lender. Differences also emerged with regard to the distinction between full-time intermediaries and those offering credit in an ancillary capacity.

Most financial services industry federations were supportive of a registration and supervision regime for credit intermediaries. Some federations mentioned that any registration and/ or supervision requirements should apply only to independent credit intermediaries, as tied credit intermediaries operate under the responsibility of the lender. Another service provider stressed that lenders should control credit intermediaries and be liable for their activities. It was also suggested that the Commission take into consideration the specific position of microfinance providers and other social lenders when looking at requirements for credit intermediaries.

Financial services industry federations supported a requirement for professional indemnity insurance. Many also argued that indemnity insurance was not necessary for tied credit intermediaries. A capital requirement was seen as a disproportionate tool, which would establish excessively high barriers to entry to the profession. Some large EU-level financial services industry federations argued that independent credit intermediaries should be required to adhere to the same (self-regulatory) selling practices rules lenders have in place for their own staff and tied credit intermediaries. Many of the industry representatives, especially those representing credit intermediaries themselves, are supportive of minimum competency or professional training requirements, although the views are divided over whether or not a self-regulatory programme would suffice to deliver the desired outcome. Finally, it was mentioned that, as credit intermediation is mainly a locally-offered service, it should be up to Member States to decide on the level of requirements that would be appropriate to their individual markets.

In general, financial services providers regard adequate disclosure of commission structures as resolving the problem of incentives. Several mentioned that the existence of commission to credit intermediaries should be reported, but not the amount. Financial sector trade unions are keen for remuneration to be decoupled from the sale of individual products, but to be based on good service and the long-term interest of the firm.

5.4.3. Credit intermediaries

Associations representing intermediaries themselves supported a unified approach, including the registration with and supervision by one single authority per Member State for both mortgage and consumer credit. They argued that differentiated rules for full time and other intermediaries discriminated against those full time intermediaries offering a professional level of service. One association pointed to the particular difficulty presented by multi-tied intermediaries, whose status is not understood by the borrower, who may believe they offer a full market search.

Non-financial services industry federations generally supported a distinction between full-time and other intermediaries, with examples given from the motor industry, where the credit is provided to support the sale of the product rather than as a stand-alone activity. These actors also argued that the lender, not the intermediary, takes the lending decision.

On the merits of registration and supervision for credit intermediaries and on requirements that credit intermediaries would have to fulfil in order to be able to perform their function, representatives of the credit intermediary sector were generally supportive of a registration and supervision regime for credit intermediaries. However, they were split between those representing full-time credit brokers, who wished to see a level playing field, with all players being registered and supervised, and representatives of point of sale credit intermediaries, home credit providers and motor finance providers who saw registration and supervision of individual credit intermediaries in these sectors as being a disproportionate measure.

Some intermediaries associations supported a requirement for professional indemnity insurance, although some argued this was unnecessary for home credit agents and point of sale intermediaries. Many also argued that indemnity insurance was not necessary for tied intermediaries. A capital requirement was also seen as a disproportionate tool, which would establish excessively high barriers to entry to the profession. Many of the intermediaries industry representatives are supportive of minimum competency or professional training requirements, although the views are divided over whether or not a self-regulatory programme would suffice to deliver the desired outcome.

Associations representing credit intermediaries call for any requirements applicable to their members to also apply to bank branch staff, to ensure a level playing field.

5.4.4. Member States

Member State authorities were generally supportive of using the CCD definition of credit intermediaries as a base from which to work, although a number of Member States mentioned that it is too early to assess whether it is appropriate to use this definition for Mortgage Credit, given that the CCD had yet to enter into force. A small number of Member State authorities supported taking a regulatory approach based on the risk of consumer detriment of a given activity, rather than an approach based on the role or status of the intermediary.

Member State authorities also support a registration and supervision framework for credit intermediaries. Some have the view that credit intermediaries should be able to prove their competency according to the products they distribute and the activities they perform. A few also mentioned the need for not only initial competency proof, but for continuing professional development of the intermediary. A small number of Member States where credit intermediaries do not have a large market share noted that self-regulatory initiatives to ensure the probity and professional competency of credit intermediaries would be sufficient and cost-effective.

Most Member State authorities supported the approach of increased transparency in the disclosure of commissions and fees. Some supported combining this with general rules to act in the interest of the customer. Others were in favour of applying rules in this regard to all distributors, whether bank staff or credit intermediaries. Several mentioned the adequacy of the CCD provisions, particularly with regard to disclosure of fees payable by borrowers to the intermediary. One authority supported the establishment of clear guidelines for remuneration structures, the implementation of which could be overseen by supervisors, while another Ministry of Finance stated governments should not get involved in fee levels or calculation methods.

5.5. Objectives

5.5.1. General objectives

– To create an efficient and competitive Single Market for consumers, creditors and credit intermediaries with a high level of consumer protection by fostering:

  – consumer confidence;

  – customer mobility;

  – cross-border activity of creditors and credit intermediaries;

  – a level playing field.

– Promote financial stability throughout the EU by ensuring that mortgage credit markets operate in a responsible manner.

5.5.2. Specific objectives

– Ensure appropriate regulatory regime for credit intermediaries to integrate the Single Market for intermediation

5.5.3. Operational objectives

– Ensure that all credit intermediaries are appropriately registered, authorised, and supervised.

– Ensure that credit intermediaries operate in a responsible way within the EU market.

– Ensure that there is a level playing field between credit intermediaries, and credit intermediaries and other market players.

5.6. Description of policy options

5.6.1. Authorisation and registration

5.6.1.1. Option 1.1: Do nothing

Doing nothing means that no initiatives at the EU level would be undertaken to regulate the process and requirements for the authorisation and registration of mortgage credit intermediaries, particularly independent credit intermediaries. As a result, the above identified problems will continue.

5.6.1.2. Option 1.2: Principles-based requirements

Under this option general EU principles will be issued for Member States to ensure that mortgage credit intermediaries are adequately authorised and registered by the competent authority of the Member State where they are based. It will be left to the Member States to determine the conditions, minimum standards and the professional requirements for the authorisation and registration of mortgage credit intermediaries.

5.6.1.3. Option 1.3: Specific requirements

The objective of this option would be to draft specific requirements for mortgage credit intermediaries in order to undertake and pursue the activity of credit intermediation. The Commission could propose specific rules regarding the authorisation and registration of credit intermediaries, such as the obligation to set up a register or the obligation to be registered with a competent authority. Rules would also refer to the professional standards that need to be complied with for credit intermediaries to be allowed to take up the activity. In the event a legislative instrument is chosen, regulatory standards could also be considered if necessary specifying certain aspects, such as the professional standards.

5.6.1.4. Option 1.4: Introduction of a passport

Subject to a proper authorisation and supervision of credit intermediaries, under this option, rules will be established for an EU passport for mortgage credit intermediaries. This passport would allow mortgage credit intermediaries, which are duly authorised and supervised in their home Member States, to be able to provide services anywhere in the Internal Market based on the principle of freedom of establishment or freedom to provide service (Articles 43 and 49 EC Treaty) without any further authorisation or registration.

5.6.2. Prudential requirements and supervision

5.6.2.1. Option 2.1: Do nothing

This option means that no action will be taken at EU level regarding the prudential requirements such as adherence to a compensation scheme, initial or own capital for credit intermediaries. Supervision will remain the responsibility of Member States and, therefore, there is a risk that it will continue to be absent in those Member States which do not yet have any supervision in place.

5.6.2.2. Option 2.2: Principles-based requirements

For this option general principles will be established for Member States to ensure that credit intermediaries are subject to proportionate prudential requirements both on an initial and ongoing basis. The principles will also stipulate that Member States shall ensure that credit intermediaries authorised to act shall be subject to supervision by the competent authorities. The supervision provisions will deal with prudential and ongoing requirements as well as conduct of business rules that credit intermediaries would have to meet in order to be able to continue providing intermediation services.

5.6.2.3. Option 2.3: Specific requirements

With this option, specific rules will be established at EU level detailing prudential requirements for credit intermediaries. The specific rules could stipulate that credit intermediaries could be required to adhere to a compensation scheme covering the territories in which they offer services or some comparable guarantee against the liability arising from professional negligence. These rules could also require credit intermediaries to hold minimum initial capital or ongoing capital. Rules could also be established at EU level stipulating specifically the aspects and the technical instruments such as their operation processes, level of initial capital, own funds, conflict of interest and remuneration policies of credit intermediation that have to be supervised by the competent authorities.

5.6.2.4. Option 2.4: Introduction of EU level supervision

An entity at EU level will develop binding technical standards, collect micro-prudential data, and ensure coordinated supervisory activities. The EU authority will act as an overarching supervisor of all national supervisors and may take decisions to take action with regard to individual credit intermediaries on its own if deemed necessary. This supervision could take place by one of the three European Supervisory Authorities like the European Banking Authority that is to be established. The national competent authorities will still be monitoring credit intermediaries' activities at national level.

5.7. Description of options for policy instruments

Each of the above options could be given effect through a variety of different policy instruments. These include a Commission Recommendation, industry self-regulation (Code of Conduct), and Community legislation in the form of a Regulation or Directive. The table below explores the feasibility of giving effect to each of our policy options through each of the available policy instruments.

Table 40: Credit intermediaries – Policy options versus instrument

Doing nothing does not require the use of any policy instrument. A Communication would be unable to give affect to any of the abovementioned policy options: it is a tool used simply to

Policy options: content vs instrument	Self-regulation	Recommendation	Communication	Directive	Regulation
Authorisation and registration					
1.1: Do nothing					
1.2: Principles-based requirements		X		X	
1.3: Specific requirements		X		X	
1.4: Introduction of a passport		X		X	
Prudential requirements and supervision					
2.1: Do nothing		X		X	
2.2: Principles-based requirements		X		X	
2.3: Specific requirements		X		X	
2.4: Introduction of EU level supervision		X		X	

communicate information to the Member States. Self-regulation is also likely to be ineffectual in this instance. The nature of registration, authorisation and supervisory regimes are such that they involve a competent authority, usually a public one. To establish such powers a legal act would be required, either on a national or EU level. Consequently, self-regulation can also be discarded at this stage.

5.8. Assessment of policy options

5.8.1. Authorisation and registration

5.8.1.1. Option 1.1: Do nothing

<u>Effectiveness of policy option</u>

The general effect of this option is that there will not be a basis for a general policy to ensure an appropriate regime for credit intermediaries in order to integrate the Single Market for intermediation. The current conditions, minimum standards and professional requirements for the authorisation and registration of credit intermediaries of the different Member States will continue to be highly varied. This discrepancy will maintain the unlevel playing field between different actors and the possibilities for regulatory arbitrage both within and between Member States. Furthermore, if no action is taken, market failure and consumer detriment will continue.

More specifically, due to the absence of authorisation requirements and registration of credit intermediaries, new entrants could easily enter the market in half of the Member States. As explained above, this could have potential negative effects on market stability in the long run. Moreover, if no action is taken in this field, consumers would not be able to obtain access to alternative redress schemes when things go wrong if the credit intermediary is neither authorised nor registered[813]. Finally, the lack of comparable authorisation and registration regime will be an obstacle for credit intermediaries wishing to offer their services throughout the EU.

[813] See footnote 6.

Impacts of policy option on stakeholders and efficiency

If no action is taken, credit intermediaries will benefit from the fact that they can easily enter the market and perform intermediation services without being subject to regulatory burdens in the majority of Member States that do not have specific regulation on credit intermediation[814]. On the other hand, credit intermediaries will be prevented from taking advantage of opportunities to go cross-border as they will need to comply with different national requirements leading to higher costs and reduced economies of scale and scope.

Doing nothing means that it will continue to be difficult for mortgage lenders to assess the trustworthiness or competence of independent credit intermediaries. In view of the higher reputational risk they may continue to rely predominately on tied credit intermediaries.

For Member States, there is in principle, no specific positive or negative impacts as Member States' authorities can decide whether and when to act with regard to the authorisation and registration of credit intermediaries. In this way they can foresee any costs with regard to the implementation, enforcement and monitoring of any regulations in this respect. However, the general negative impact for Member States' economy and society will be that unregulated credit intermediaries may enter the market and recommend unsuitable products[815] or provide wrong advice. This will increase the risk of credit defaults, overindebtedness and foreclosures.

Consumers will be economically and socially negatively impacted under this option. They will not be able to know if the person in front of them is competent and authorised to provide intermediation services. This would contribute to lower consumer trust, which may then translate in lower demand for credit intermediation services. This option will thus impose costs to the overall society[816].

5.8.1.2. Option 1.2: Principles-based requirements

Effectiveness of policy option

Principles-based rules would ensure that all Member States have a minimum level of authorisation and supervision, without going into too much detail as to how this would be done. Member States that do not currently have any registration and authorisation regimes will be required to establish them. These principles will create benchmarks for the entry of credit intermediaries into the market and a certain level playing field between credit intermediaries at national level. This is beneficial to consumers and lenders who will have more confidence to use credit intermediaries.

However, there will still be discrepancies between Member States regarding minimum standards and professional requirements for the authorisation and registration of credit intermediaries. Some Member States will have more stringent and others less stringent minimum entry and professional requirements in order to be able to provide credit intermediation services. This can lead to cross-border regulatory arbitrage in the field of credit

814 See footnote 6.

815 See footnote 6.

816 See footnote 6. Europe Economics estimated that if 1 % of all mortgages intermediated in 2007 (i.e. about EUR 564 billion) were overpriced by one basis point, the incremental costs to consumers would be EUR 0.5 million).

intermediation. In addition, given those discrepancies, under this option, it will still be difficult and costly for credit intermediaries to provide services cross-border and, thus, to create a single market for credit intermediation.

Impacts of policy option on stakeholders and efficiency

The expected benefit for consumers is considered to be the possibility to contract with duly authorised and skilled credit intermediaries. The risk of consumer detriment in the form of fraud, recommended expensive and unsuitable mortgages, and overcharging should be lower. Moreover, this should reduce the likelihood and risks of defaults, overindebtedness and foreclosure, as well as of financial instability. In addition, regulated and registered credit intermediaries are assumed to boost consumer confidence and trust and therefore their demand for intermediation services. However, this increase in demand will most probably remain a domestic impact. As national rules are expected to remain different, consumers will not benefit from the same level of protection within the EU, and will be more reluctant to shop across borders. Furthermore, the size of the benefits for consumers would vary depending on the quality and scope of rules introduced by Member States.

The actual economic impacts on credit intermediaries will depend on the exact rules adopted in their respective Member State. Credit intermediaries in Member States[817] without specific regulation for credit intermediation will incur costs derived from the implementation of the new national rules which regulate credit intermediation according to the EU principles. However, for credit intermediaries who are already subject to national credit intermediation regulation, economic impacts are assumed to be in the form of adaptation costs due to the possible change of national rules and, therefore, lower. However, given that the new EU rules would be principles-based, it is assumed that modifications and, thus, additional costs would be minimal.

For credit intermediaries willing to operate cross-border, compliance costs are estimated to remain important due to different rules at national level. As a result, increases in cross-border activity are considered to be limited within this option thus protecting national market from the competition of foreign players. Due to the new authorisation obligations, credit intermediaries may incur annual recurring costs for renewing their authorisation and registration with the competent authorities. It is possible that credit intermediaries will try to pass part of the incremental costs on to the consumers.

The unlevel playing field between mortgage lenders and credit intermediaries would be limited as both now would face authorisation and registration requirements. This option could also help enhance lender confidence in the abilities of credit intermediaries, thus their use of credit intermediaries. This could therefore provide a boost in cross-border activity by mortgage lenders through the use of local credit intermediaries, reducing the costs of cross-border activity and improving competition. Mortgage lenders themselves should not face any costs.

There are costs involved for Members States for the development, enforcement and monitoring of the national rules established according to the EU principles-based rules. In addition, Member States will need to foresee additional ongoing financial and human

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817 See footnote 6. According to Europe Economics these are Denmark, Estonia, Cyprus, Latvia, Lithuania, Luxembourg, Poland, Portugal and Slovakia.

resources to assess credit intermediaries for authorisation and administer the public register. The setting up of the register is assumed to entail one-off costs.

The estimated impact of the introduction of principles is different between Member States. As described in Section 6.2.2, some Member States already require credit intermediaries to be authorised and/or registered. The cost implications for introducing EU principles are thus different in those Member States that have regulation in place.

Possible positive impacts for Member States are the flexibility and the possibilities provided by the margin of discretion to transpose the EU principles in line with their national preferences, cultural specificities and market size. Thus national rules should be more effective and proportionate.

In conclusion, the overall impact of the option is that credit intermediaries and Member States will incur costs depending on the national rules established to adhere to the principles and the risk to consumer detriment will be minimised to a certain extent in comparison to the scenario when no action is taken.

Quantification of costs and benefits

The benefit for consumers is estimated to be between EUR 20.0 million and EUR 40.1 million. This benefit would arise through fewer defaults for consumers, reducing overall consumer detriment. This can be broken down as follows.

– At current the value of mortgage loans in EUR 1 244 966 million of which 41.5 % is intermediated, this is EUR 516 661 million.

– The default rate of all mortgages is estimated at 1.43 % in 2007.

– It is assumed that if the number of defaults of intermediated loans is reduced by 0.5 up to 1 basis point, the benefit for consumers would be in the range of EUR 25.8 million up to EUR 51.6 million.

– A discount is applied of 22 % as six Member States[818] are consider to have already today a high level of regulatory requirements in place.

Credit intermediaries could be subject to one-off costs in order to comply with the requirements and standards for authorisation and registration. These one-off costs are put at EUR 15.5 million and recurring costs at EUR 12.9 million. This can be broken down as follows.

– All credit intermediaries are assumed to need to pay a registration fee to cover for the costs of authorisation. These are estimated at EUR 1 500 per credit intermediary, representing EUR 19.9 million for all credit intermediaries.

– Credit intermediaries will possibly need to pay an annual recurring authorisation fee of EUR 1 000 to remain registered. This would lead to a cost of EUR 13.3 million for all credit intermediaries.

[818] Ireland, Hungary, Malta, the Netherlands, Austria and the United Kingdom. See footnote 6.

– In addition, to comply with annual authorisation and reporting requirements, credit intermediaries are expected to devote annually 8 hours at an hourly rate of EUR 31.56. This would lead to a total cost of EUR 3.4 million for all credit intermediaries.

– It needs to be taken into account, as described above, that a number of credit intermediaries already have gone through this process of complying with certain conditions. Therefore a discount of 22 % is applied as six Member States[819] are considered to have currently a high level of rules in place.

It is assumed that Member States will incur costs of EUR 0.9 million for implementing an authorisation system and a register and an annual recurring cost of EUR 1.6 million to ensure enforcement and monitoring of the authorisation.

One-off costs can be broken down as follows.

– The one-off cost to establish rules on authorisation and registrations is estimated at EUR 23 529 per Member State or a total cost of EUR 0.6 million.

– In addition, Member States would need to set up a register which is expected to take 30 man hours per Member State leading to a total cost of EUR 0.2 million.

– Next to this, it is assumed that Member States would have 4 man hours of staff per expenses per credit intermediary to ensure an enterprise can be entered in the register.

– A reduction of 22 % is applied on one-off costs for Member States as six Member States[820] are considered to have currently a high level of rules in place.

Annual recurring cost can be broken down as follows.

– In addition, Member States would have recurring costs to annually renew the authorisation and registration of credit intermediaries, which is assumed to consumer 4 man hours per credit intermediary or EUR 1.6 million for all credit intermediaries.

– In addition, Member States are expected to deal with market entry of new credit intermediaries which could make 10 % of all credit intermediaries (representing 1 330 credit intermediaries) or a total cost of EUR 0.3 million if it is assumed that on average 8 man hours are attributed to ensure the authorisation and registration process.

– A reduction of 22 % is applied on recurring costs for Member States as six Member States[821] are considered to have currently a high level of rules in place.

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819 See footnote 818.
820 See footnote 818.
821 See footnote 818.

5.8.1.3. Option 1.3: Specific requirements

Effectiveness of policy option

This option will also address the problem of regulatory gaps concerning the authorisation and registration of credit intermediaries at EU level. If specific rules would be established credit intermediaries will be subject to the same minimum standards and professional requirements for authorisation and registration throughout the European Union. This will create legal certainty and a level playing field between all intermediaries within the EU. Member States that do not currently have any registration and authorisation regimes will be required to establish them. Member States that do currently have registration and authorisation would most likely however have to adapt them. In contrast to the previous option, this option reduces the scope for regulatory arbitrage. This is beneficial to consumers who will have more confidence to use credit intermediaries.

Specific rules outlining amongst other things a fit and proper test, minimum qualifications for credit intermediaries, etc. would also contribute to raising the level of consumer protection and creating a level playing field. They will foster confidence in the market as consumers can undertake transactions with the assurance that the credit intermediaries they use are at authorised, fit and proper and registered with a competent authority.

Impacts of policy option on stakeholders and efficiency

In respect to consumers, the impact will be positive as the specific rules will create transparency with regard to entry barriers for credit intermediation and thus increase consumer trust. In addition, with these rules, consumers are likely to be protected from unauthorised credit intermediaries entering the market. This should reduce the likelihood and risk of defaults, overindebtedness and foreclosure and improve financial stability. In addition, regulated and registered credit intermediaries are assumed to boost consumer confidence and trust throughout the EU. However, there might be unexpected negative economic impacts if credit intermediaries pass on the costs to adhere to more stringent rules to consumers. In this respect the benefits of regulation may be offset by the cost of implementing it.

The establishment of EU-wide rules would provide credit intermediaries with greater possibilities of providing more easily intermediation services cross-border as they only need to comply with one instead of 27 regimes, thus reducing compliance costs and creating business opportunities. Furthermore, these rules could provide a great degree of legal certainty in providing intermediation services cross-border which will encourage credit intermediaries to enter the market. This would, in turn, translate into a greater choice of intermediary services for consumers. A further possible benefit is that the EU-wide rules could enhance a level playing field between credit intermediaries and the integration of the credit intermediation market and foster competition.

The unlevel playing field between mortgage lenders and credit intermediaries would be reduced as both now would face authorisation and registration requirements. This option could also help enhance lender confidence in the abilities of credit intermediaries, thus their use of credit intermediaries. This could therefore also provide a boost in cross-border activity by mortgage lenders through the use of local credit intermediaries, reducing the costs of cross-border activity and improving competition. Mortgage lenders themselves would not face any costs.

Even if the EU requirements represent the maximum common denominator, all Member States will incur costs to implement the new rules. However, these costs will be higher in those Member States which do no have any requirement regarding the registration and authorisation of credit intermediaries in place (see Section 6.2.2). Member States would have to train their staff and set up assessment processes or adapt existing training and processes in order to comply with the EU-wide rules. They may also need to establish a register or increase the existing register resources.

<u>Quantification of costs and benefits</u>

The benefits of specific rules accruing to consumers in monetary terms are based on the assumption that EU-wide rules could create a great degree of legal certainty, boost consumer confidence in credit intermediation and make credit intermediaries lend more responsibly all leading to a decrease in defaults. The benefits to consumers are thus estimated at between EUR 40 million to EUR 80 million. This is broken down as follows.

– At current the value of mortgage loans in EUR 1 244 966 million of which 41.5 % is intermediated, this is EUR 516 661 million.

– The default rate of all mortgages is estimated at 1.43 % in 2007.

– It is assumed that if the number of defaults of intermediated loans is reduced by 1 up to 2 basis points, the benefit for consumers would be in the range of EUR 51 million up to EUR 103 million.

– A discount is applied of 22 % as six Member States[822] are consider to have already today a high level of regulatory requirements in place.

Credit intermediaries could be subject to one-off costs in order to comply with the requirements and standards for authorisation and registration. These one-off costs are put at EUR 19.9 million and recurring costs at EUR 16.7 million. This can be broken down as follows.

– All credit intermediaries are assumed to need to pay a registration fee to cover for the costs of authorisation. These is estimated at EUR 1 500 per credit intermediary, representing EUR 19.9 million for all credit intermediaries.

– Credit intermediaries will possibly need to pay an annual recurring authorisation fee of EUR 1 000 to remain registered. This would lead to a cost of EUR 13.3 million for all credit intermediaries.

– In addition, to comply with annual authorisation and reporting requirements, credit intermediaries are expected to devote annually 8 hours at an hourly rate of EUR 31.56. This would lead to a total cost of EUR 3.4 million for all credit intermediaries.

– As specific rules are expected to lead to changes in all Member States, the additional costs are calculated taken into account all credit intermediaries. However, it could be

[822] See footnote 818.

assumed that this is an overstatement as some Member States[823] have already a high level of rules in place and therefore actual incremental costs for credit intermediaries could be lower depending on the difference between the new specific rules and the current rules in place.

It is assumed that Member States will incur costs of EUR 1.2 million for implementing an authorisation system and a register and an annual recurring cost of EUR 2 million to ensure enforcement and monitoring of the authorisation.

The setup cost can be broken down as follows.

– The one-off cost to establish rules on authorisation and registrations is estimated at EUR 23 529 per Member State or a total cost of EUR 0.6 million.

– In addition, Member States would need to set up a register which is expected to take 30 man hours per Member State leading to a total cost of EUR 0.2 million.

– Next to this, it is assumed that Member States would have 4 man hours of staff per expenses per credit intermediary to ensure an enterprise can be entered in the register. This would lead to a cost of EUR 0.4 million.

– A reduction of 22 % is applied on one-off costs for Member States as six Member States[824] are considered to have currently a high level of rules in place.

The recurring cost can be broken down as following.

– Member States would have recurring costs to annually renew the authorisation and registration of credit intermediaries, which is assumed to consumer 4 man hours per credit intermediary or EUR 1.6 million for all credit intermediaries.

– It is assumed that there are each year 10 % new market entrants to be authorised and registered, which corresponds to 1 330 entities. Member States are assumed to attribute on average 8 man hours to perform authorisation and registration leading to a total cost of EUR 0.3 million.

– A reduction of 22 % is applied on recurring costs for Member States as six Member States[825] are considered to have currently a high level of rules in place.

5.8.1.4. Option 1.4: Introduction of a passport

Effectiveness of policy option

The introduction of a passporting regime for credit intermediaries will foster the integration of the market for credit intermediation and, therefore, be effective in creating an efficient and competitive single market. Credit intermediaries will be given the possibility to provide intermediation services without the regulatory burden of having to ask for authorisation/registration in each of the host Member States where they wish to operate. The introduction of a passport regime for credit intermediaries will increase competition and

[823] See footnote 818.
[824] See footnote 818.
[825] See footnote 818.

create a level playing field between credit intermediaries and mortgage lenders. Furthermore, it will create new business opportunities for both credit intermediaries and lenders.

Impacts of policy option on stakeholders and efficiency

Credit intermediaries will be both positive and negatively impacted. The positive impact will be less regulatory barriers to going cross-border, thus greater business opportunities. A negative impact might be that Member States require higher requirements in order to qualify for a passport. Thus, this option could be combined with either Option 1.2 or Option 1.3 as described above. As such, these impacts will not be considered here.

For Member States there will be considerable impacts as the home Member State has to extend its supervision for credit intermediary which operate cross-border.

Consumers will perceive positive impacts as the 'free movement of credit intermediaries' will provide a greater choice in credit intermediation and credit products based on properly authorised and registered credit intermediaries.

Quantification of costs and benefits

The Commission services consider that there will be positive benefits for consumers. The services quantified the benefits for consumers in terms of greater product choice and greater choice of credit intermediaries. However, Commission services are unable to make an estimate of these benefits due to a lack of the relevant data.

Credit intermediaries would benefit from reduced compliance costs when operating cross-border due to the passport. Therefore, cross-border activity is expected to increase. However, as cross-border activity is hindered by an important number of factors already described, the sole passport is not expected to boost cross-border activity considerably.

If either Option 1.2 or 1.3 is implemented, Member States should not face incremental costs when introducing a passporting regime. It is assumed that the passport is entirely part of the authorisation process and there should not be costs on top of those calculated above.

To conclude, it could be assumed that the benefits on part of the consumers and the credit intermediaries will be small, but outweigh the costs for Member States.

5.8.2. Prudential requirements and supervision

5.8.2.1. Option 2.1: Do nothing

Effectiveness of policy option

Not introducing prudential requirements and supervision for credit intermediaries will not contribute to addressing the regulatory gaps in these fields.

As a result of no action, the EU market, in which only six Member States[826] have some sort of prudential requirements and a supervisory framework in place, will remain fragmented. In the

[826] See footnote 6. Europe Economics identified Bulgaria, Germany, Malta, Netherlands, Austria and United Kingdom as Member States that have prudential requirements in place.

rest of the Member States, maintaining the status quo, will not contribute to achieving the objective of consumer protection since it will remain easy for credit intermediaries to offer their services without being subject to prudential requirements or subject to any oversight. Maintaining different approaches as regard to prudential requirements and supervision on credit intermediaries reduces the possibilities to go cross-border as credit intermediaries will have to comply with different national regimes.

Choosing this option could put financial stability at risk, particularly where credit intermediaries hold an important share of the market. It will be also be contrary to the objectives of the G20, ensuring "that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances"[827].

Impacts of policy option on stakeholders and efficiency

Consumers however will be negatively impacted because the credit intermediaries that enter the market without the prudential requirements or supervision risk acting less prudently and are more prone to cause consumer detriment.

In general, credit intermediaries will neither be positively nor negatively impacted if no prudential requirements or supervision will be established. The existing costs to comply with national regulations will remain. However, on a cross-border basis, compliance costs with different national rules will hinder those credit intermediaries wishing to operate cross-border. Credit intermediaries in the above mentioned six Member States will be disadvantaged as the unlevel playing field for them is maintained. For credit intermediaries in other Member States there will not be additional administrative burden or costs as it would not necessary to have an initial capital and professional indemnity insurance to start. Nevertheless, not having the professional indemnity insurance may create costs for credit intermediaries in case of professional negligence.

This option will have limited economic impacts on Member States because no changes will take place unless decided by the Member States themselves.

5.8.2.2. Option 2.2: Principles-based requirements

Effectiveness of policy option

This option will contribute to address the regulatory gaps in terms of prudential requirements and supervision.

This option will equally contribute to achieving the objective of improving consumer protection as prudential rules and supervision will be established in all Member States, which will contribute to more prudent operations by credit intermediaries. However, as rules are only principles-based, the principles and national rules related thereto will be amended according to the principles, meaning that national divergences will be maintained. As a result, consumer protection might not be at the same level in all Member States.

This option will also have a positive impact on consumer mobility as consumers are expected to have more confidence in market players when they are subject to prudential requirements

827 *G20 Declaration, summit on financial markets and the world economy*, 15.11.2008, see http://www.g20.org/Documents/g20_summit_declaration.pdf.

and adequately supervised. However, as principles-based rules leave some discretion to Member States, this objective will not be fully achieved.

This option will contribute to achieving the objective of creating a level playing field between intermediaries within and between Member States, as all credit intermediaries will need to be subject to prudential requirements and will be supervised. Moreover, in this way credit intermediaries will be regulated more in line with other players in the credit market[828]. Nevertheless, as these are mere principles, Member States have a margin of discretion to impose more, or less stringent prudential rules and a different supervisory framework in comparison to other Member States. Therefore, this objective will not be fully achieved by principles-based rules.

This option will have a limited effect on improving the possibilities for credit intermediaries to go cross-border because credit intermediaries will still need to comply with the supervision requirements of the different Member States. Nevertheless, the principles will lay the basic foundation for a passporting regime for credit intermediaries.

Impacts of policy option on stakeholders and efficiency

With respect to consumers the benefits are assumed to derive from more prudent credit intermediaries who will enter the market and provide more suitable advice leading to a more prudent credit intermediation market with fewer defaults, overindebteness and foreclosures. However, this option could have negative effects on consumers as the compliance costs for credit intermediaries could be passed on to them.

There economic impacts on credit intermediaries will be higher in the 21 Member States where such requirements are not yet in place. Credit intermediaries will be subject to one-off and annual recurring costs to meet the new national prudential requirements. At a cross-border level, although a more convergent approach to prudential requirements could facilitate cross-border provision of credit intermediation services, the compliance costs for credit intermediaries will remain important as they will still need to comply with different national requirements. In addition, the economic impact on credit intermediaries depends on whether there was supervision in place in their Member States of residence or not. In any case, credit intermediaries will have to have certain processes in place in order comply with the supervision requirements or providing reports on their capital status and their compliance with conduct of business rules and their remuneration regime.

Member States will face similar administrative burdens and costs as it will be necessary to design national rules, enforce and monitor them. For Member States the costs are related to the need to stipulate the rules and regulations for supervision or credit intermediaries, have an organisation and staff in place to supervise and report on the activities of the credit intermediaries and enforcement and monitoring of the rules. Member States will need to supervise credit intermediaries with regard to the entry requirements, the ongoing requirements and prudential requirements as well as the credit intermediaries' application of conduct of business rules which will entail costs.

[828] Directives 2008/48/EC, 2004/39/EC and 2002/92/EC.

Quantification of costs and benefits

The benefit for the consumers is assumed to be in the form of a decrease of defaults of the intermediated loans. The Commission services estimated that if principles-based prudential rules could result in the benefit for consumers in terms decreased defaults in intermediated loans in the range of EUR 19.9 million up to EUR 51.0 million. This is based on following assumptions.

– At current the value of mortgage loans in EUR 1 244 966 million of which 41.5 % is intermediated, this is EUR 516 661 million. The default rate of all mortgages is estimated at 1.43 % in 2007.

– It is assumed that if the number of defaults of intermediated loans is reduced by 0.5 up to 1 basis point, the benefit for consumers would be in the range of EUR 25.8 million up to EUR 51.6 million.

– A discount is applied of 22 % as six Member States[829] are consider to have already today a high level of regulatory requirements in place.

Credit intermediaries are assumed to incur recurring costs for implementing prudential requirements and compliance with supervision. This cost amount to EUR 24.9 million.

– The costs of a adherence to a compensation scheme is based on the assumption that a risk premium of 0.004 % of the annual intermediated amount would be requested for the compensation scheme, this represent a total of EUR 20.6 million for all credit intermediaries or EUR 1 554 per credit intermediary.

– Member States are free to impose also initial and ongoing capital requirements, which would lead to additional costs to intermediaries when imposed. However, this cannot be attributed to the proposed legislation under this option.

– Credit intermediaries are assumed to incur certain recurring costs in order to enable the competent national authorities to perform the oversight controls. Credit intermediaries shall have to send an annual report to supervisors which will take 4 hours to prepare by one person for EUR 31.56 costs per hour which amounts to EUR 1.3 million of total costs for all credit intermediaries. In addition, it is assumed that 25 % of credit intermediaries will be subject to annual on-site inspection which would take 4 hours of time, generating an additional cost of EUR 0.3 million.

– A discount on the costs for credit intermediaries is applied of 22 % as six Member States[830] are consider to have already today a high level of regulatory requirements in place which credit intermediaries need to comply to.

– Credit intermediaries will be facilitated to operate cross-border due to more legal certainty. These benefits are however not quantified due to lack of available data on cross-border mortgage lending by credit intermediaries. A positive impact however can be expected.

829 See footnote 818.
830 See footnote 818.

The costs for Member States are linked to the setting up of a supervisory framework and are estimated at a one-off cost of EUR 0.5 million and a recurring cost of EUR 1.6 million. This can be broken down as following.

– The one-off cost linked to implementation of the new rules is estimated at EUR 23 529 per Member State or EUR 0.6 million for all Member States.

– The Commission services estimate that recurring costs linked to supervision include annual checking of data which would consume 4 hours per credit intermediary at an hourly rate of EUR 39.56 leading to a total cost of EUR 1.6 million for all Member States.

– In addition, it is assumed that 25 % of credit intermediaries would be subject to on-site inspections which would require 4 man hours, corresponding to a total cost of EUR 0.4 million.

– Both set-up and recurring costs are reduced with 22 % as six Member States[831] are consider to have already today a high level of regulatory requirements in place which credit intermediaries need to comply to.

5.8.2.3. Option 2.3: Specific requirements

Effectiveness of policy option

Prescriptive rules and supervision will equally address the regulatory gaps in terms of prudential requirements and supervision of credit intermediaries.

Specific prudential rules and sound oversight of credit intermediaries based on EU-wide common criteria are expected to contribute to the objective of increasing consumer protection in the intermediation process and reduce the risk for consumer detriment. Similar levels of consumer protection across the EU should encourage customer mobility.

These rules will equally contribute to improving the level playing field between credit intermediaries within and between Member States as rules will be based same prescriptive requirements in all Member States. Furthermore, by increasing legal certainty and reducing the compliance costs when operating cross-border, this option will make it easier for credit intermediaries to provide intermediation services in another Member State. In this case, there will be no leeway for Member States to gold plate and develop divergent set of rules.

Impacts of policy option on stakeholders and efficiency

The most important benefit for consumer is that rogue credit intermediaries will not be able to enter the market and due to the ongoing supervision, market will be better monitored, which could increase prudent lending and a reduced risk of defaults, overindebtedness and foreclosures. Credit intermediaries would be covered for professional negligence, which will improve consumer confidence in using credit intermediaries. However, the prudential requirements will impose some costs on credit intermediaries which they may pass on to consumers.

[831] See footnote 818.

Costs for credit intermediaries will be higher in those countries with no rules or supervision framework in place. Credit intermediaries will need to make sure that their administration and practices are in line with the new requirements. There is also the risk that, if a high level of prudential requirements is chosen, this might be an entry barrier, especially for individual untied credit intermediaries, which might find it more difficult/costly entering the market.

Member States are equally impacted as they will have to transpose, enforce and monitor the requirements and set up a supervisory framework if not yet in place. They will have to have system/procedures in order to ensure that credit intermediaries comply with the requirements. There may be a need to create or have a supervisory authority and system which has the oversight over the activities of credit intermediaries. This would mean additional ongoing supervision costs for many Member States. Also there would probably also be higher costs in adapting rules and requirements to the changing circumstances. The introduction of supervision and therefore ongoing supervision is of importance for monitoring and compliance[832].

Quantification of costs and benefits

For consumers the estimated benefit is a decrease of defaults of the intermediated loans which is estimated at EUR 25.5 million up to EUR 59.5 million. This is based on the following assumptions.

– The value of intermediated mortgage loans is EUR 516 billion which derived from taking the percentage of 41.5 % of EUR 1 224 966 million the value of the total mortgage loans in 2008. The value of default intermediated mortgage credit is based on the assumption that the default rate of 1.43 % for all mortgage loans is applicable to defaulted intermediate mortgage loans .

– If specific rules would require credit intermediaries to hold initial and ongoing capital, costs linked to this would increase correspondingly. However, for the purpose of this impact assessment, it is considered that there will not be any capital requirements imposed on credit intermediaries.

– It is assumed that if the number of defaults of intermediated loans is reduced by 0.5 up to 1.5 basis points, the benefit for consumers would be in the range of EUR 25.8 million up to EUR 51.6 million.

It is estimated by the Commission services that credit intermediaries will incur recurring costs to comply with specific rules on prudential requirements and supervision which is estimated at EUR 22.6 million. This can be broken down as following.

– The costs of a adherence to a compensation scheme are based on the assumption that a risk premium of 0.004 % of the annual intermediated amount would be requested for the compensation scheme, this represent a total of EUR 20.6 million for all credit intermediaries or EUR 1 554 per credit intermediary.

832 *Assessing the effectiveness of enforcement and regulation*, City of London, http://217.154.230.218/NR/rdonlyres/7A1E6585-3A23-4F09-BB4E-8E9FB471E117/0/BC_RS_Assessing_Effectiveness_Enforcement_Regulation.pdf.

– Credit intermediaries will also incur a cost of capital as a result of the initial and ongoing capital requirements that would be introduced. This cost, however, would depend very much on the chosen capital level and the applicable interest rate. It has therefore been impossible to estimate. This cost of capital is however expected to be higher than under Option 2.2 (where Member States would be free to determine the level of capital most adequate to national circumstances).

– Credit intermediaries are assumed to incur certain recurring costs in order to enable the competent national authorities to perform the oversight controls. Credit intermediaries shall have to send an annual report to supervisors which will take 4 hours to prepare by one person for EUR 31.56 costs per hour which amounts to EUR 1.3 million of total costs for all credit intermediaries. In addition, it is assumed that 25 % of credit intermediaries will be subject to annual on-site inspection which would take 4 hours of time, generating an additional cost of EUR 0.3 million.

– As new specific rules are to be introduced, all credit intermediaries are expected to incur costs. However, six Member States[833] have already today a high level of regulatory requirements in place which credit intermediaries need to comply to. Therefore, actual incremental costs will be most likely lower.

– Specific rules on prudential requirements and supervision are expected to facilitate to cross-border provision of intermediation services due to more legal certainty. These benefits are not quantified due to lack of available data on cross-border mortgage lending by credit intermediaries. A positive impact however can be expected.

– Credit intermediaries are assumed to incur certain costs in order to enable the competent national authorities to perform the oversight controls. Credit intermediaries shall have to send an annual report to supervisors which will take 4 hours to prepare by one person for EUR 31.56 costs per hour which amounts to EUR 1.6 million of total costs for all credit intermediaries. In addition, it is assumed that 25 % of credit intermediaries will be subject to annual on-site inspection which would take 4 hours of time, generating an additional cost of EUR 0.3 million.

The costs for Member States are linked to the setting up of a supervisory framework and are estimated at one-off cost of EUR 0.5 million and a recurring cost of EUR 1.6 million. This can be broken down as following.

– The one-off cost linked to implementation of the new rules is estimated at EUR 23 529 per Member State or EUR 0.6 million for all Member States

– The Commission services estimate that recurring costs linked to supervision include annual checking of data which would consume 4 hours per credit intermediary at an hourly rate of EUR 39.56 leading to a total cost of EUR 1.6 million for all Member States.

– In addition, it is assumed that 25 % of credit intermediaries would be subject to on-site inspections which would require 4 man hours, corresponding to a total cost of EUR 0.4 million.

[833] See footnote 818.

– Costs are not discounted as it is expected that all Member States will need to migrate towards the new rules. However, this can be considered as slightly overstating the incremental costs as six Member States[834] are considered to have already today a high level of regulatory requirements in place which credit intermediaries need to comply to.

5.8.2.4. Option 2.4: Introduction of EU level supervision

Effectiveness of policy option

This option will contribute to the objective of addressing regulatory gaps in prudential requirements and supervision as the supervision of credit intermediaries will be coordinated at EU level. However, in view of the limited level of cross-border activity of credit intermediaries, as indicated in the Study on Credit intermediaries in the Internal Market, the establishment of a supervisory authority appears as a disproportionate measure. Credit intermediaries do not have a significant market share at EU level.

Impacts of policy option on stakeholders and efficiency

The impact of this option is mostly applicable to the Member States that will incur costs in cooperating and communicating with the EU level authority. The Member States' supervisory authorities will need to establish an administration that reports, and have other institutional arrangements to allow for the EU authority to function. The benefits of the EU supervision is that national problems will be discussed at EU level and therefore faster action and a more harmonised response can be taken if problems occur in one Member State, avoiding the spreading of risks within the EU. Credit intermediaries will only be impacted to the extent that there will be another higher authority which can impose certain requirements. The benefits for consumers of an EU level supervision of credit intermediaries will be legal certainty, a higher level of consumer protection and the guarantee that financial stability is improved.

Quantification of costs and benefits

It is expected that a better exchange of information will have a positive impact on the default levels. Reductions in defaults are estimated in the range of EUR 0–19.8 million.

– The value of intermediated mortgage loans is EUR 516 billion which derived from taking the percentage of 41.5 % of EUR 1 224 966 million the value of the total mortgage loans in 2008. The value of default intermediated mortgage credit is based on the assumption that the default rate of 1.43 % for all mortgage loans is applicable to defaulted intermediate mortgage loans.

– The Commission services estimated that EU supervision will reduce risk of spreading of problems arising in individual Member States and this could reduce the default rate up to 0.5 basis points, the benefit for consumers could be a decrease up to of EUR 19.8 million of the defaulted loans.

This option would not generate any incremental costs for credit intermediaries, as these are considered part of the costs of compliance to specific rules.

[834] See footnote 818.

The costs for Member States public authorities of EU level supervision are based on the assumption that 4 meetings will be organised per year, representing EUR 0.1 million. One-off costs for Member States are estimated to be part of implementing specific rules.

5.8.3. Comparison of options

5.8.3.1. Authorisation and registration of credit intermediaries

The analysis of the options above demonstrates that the objectives of this initiative cannot be achieved under the 'No action' scenario. It has been shown that this option is not effective as it preserves the status quo and thus all the problems that have been identified in the problem section.

Table 41: Authorisation and registration of credit intermediaries – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure appropriate regulatory regime for credit intermediaries to integrate the Single Market for intermediation	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1.1: Do nothing	0	0	0	0	0	0	0
1.2: Principles-based requirements	✓✓	✓	0	✓	✓	✓✓	✓
1.3: Specific requirements	✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓✓
1.4: Introduction of a passport	✓✓	**0**	**0**	✓✓✓	✓✓✓	**0**	✓✓

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Option 1.2 was found to contribute to ensuring an appropriate regime for uptake pursuit a supervision of credit intermediaries. More particularly this option is considered effective in meeting the objective of improving consumer protection and is more effective then the 'Do nothing' option with regard to achieving the objectives of ensuring a level playing field and ensuring a harmonised and proportionate registration and supervision.

However it is less effective, in comparison with Option 1.3 to tackle barriers to cross-border mobility and ensuring a level playing field between credit intermediaries as national rules will continue to differ. Option 1.3 (specific rules) is considered more effective in achieving the objective of minimizing consumer detriment and promoting cross-border activity in comparison with Option 1.2.

Finally, Option 1.4 is considered to be the most effective in promoting cross-border activity and ensuring a level playing field between all players.

Table 42: Authorisation and registration of credit intermediaries – Impacts on main stakeholders

	Consumers and society	Credit intermediaries	Creditors	Member States
1.1: Do nothing	0	0	0	0
1.2: Principles-based requirements	✓✓	×/0	✓	×/0
1.3: Specific requirements	✓✓✓	××/×	✓✓	×/0
1.4: Introduce a passport	✓	✓✓	✓	×/0

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive impact
××× (Strong) – ×× (Moderate) – × (Weak) negative impact – 0 neutral impact

In terms of benefits and costs, the do nothing scenario does not entail any financial costs or benefits.

Options 1.2 and 1.3 are expected to bring benefits to consumers as the introduction of authorisation registration requirements are expected to increase consumer protection and reduce default levels by consumers. Option 1.3, has the potential to bring more benefits than Option 1.2, as under the latter, consumer protection levels will continue to vary among Member States depending on the national implementation of EU rules. In terms of costs for credit intermediaries, Option 1.2 is expected to generate fewer costs then Option 1.3 to execute the process of authorisation as in Option 1.3 all credit intermediaries are expected to change the processes due to EU-wide rules, while with Option 1.2, authorisation and registration requirements will change only in some Member States. However, differences in cost between both systems are limited. In addition, the additional benefits of Option 1.4 are limited, both for consumers and credit intermediaries due to the limited market share and limited cross-border activity of credit intermediaries.

Under Options 1.2 and 1.3, it can be expected that creditors will be able to rely more on the credit intermediaries they work with and that they would face a lower reputational risk. Reduced barriers for the cross-border activity of credit intermediaries should also bring new business opportunities for creditors using credit intermediaries as a gate to other countries' markets. This should be higher under Option 1.4.

Regarding Member States, the costs for public authorities to implement Options 1.2, 1.3 and 1.4 are largely similar and substantially low. As such for Member States economies, the increased market stability is expected to be a positive effect from all options except for the status quo.

Table 43: Authorisation and registration of credit intermediaries – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 1.1	Option 1.2	Option 1.3	Option 1.4
Consumer/social benefits: reduction in defaults **Credit intermediary benefits:** cross-border cost savings value of business opportunities	 0 0	 20.0–40.1 Not quantifiable	 40.1–80.4 Not quantifiable	 – Not quantifiable
Total EU costs (million EUR)	Option 1.1	Option 1.2	Option 1.3	Option 1.4
Credit intermediary costs: one-off recurring **Member State costs:** one-off recurring	 0 0 0	 15.5 12.9 0.9 1.6	 19.9 16.7 1.2 2.0	 – – – –

5.8.3.2. Prudential requirements and supervision

Maintaining the existing situation of the 'Do nothing' scenario will entail status quo and therefore is not expected to contribute to any of the policy objectives.

Table 44: Prudential requirements and supervision of credit intermediaries – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure appropriate regulatory regime for credit intermediaries to integrate the Single Market for intermediation	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1.1: Do nothing	0	0	0	0	0	0	0
1.2: Principles-based requirements	✓✓	✓✓	**0**	✓	✓	✓✓	✓✓
1.3: Specific requirements	✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓
1.4: Introduction of EU level supervision	✓	✓	✓	✓	✓	✓	✓

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Introducing principles-based rules is expected to contribute to the objective of improving consumer protection in Member States with no rules in place for credit intermediaries; prudential requirements will be introduced and Member States will start set up a supervisory framework. In addition, this option will contribute to achieving the objective of on tackling cross-border mobility. In addition, contribution to the creation of a level playing field between all market players will be limited to the 'national level' as EU rules will continue to differ.

The introduction of specific rules is expected to have a greater impact on the objective of consumer protection than principles-based rules, as the level of consumer protection will be equal across all Member States. In addition, this option will have a more positive impact to cross-border mobility of credit intermediaries and will better create a level playing field between all providers as it would generate more legal certainty as same specific rules would need to be applied in all Member States. However, this option is less cost-efficient in comparison with principles-based rules as it would request all Member States to adapt their rules and supervisory framework to the EU rules for credit intermediaries.

Despite this, the introduction of principles-based rules is not expected to be efficient in tackling cross-border activity in comparison with specific rules which could enhance legal certainty for credit intermediaries willing to offer their services cross-border. Overall, in view of the limited market share and limited cross-border activity of credit intermediaries, while the introduction of specific rules might be more efficient in creating a harmonised legal framework for the supervision of credit intermediaries, the introduction of principles-based rules could be considered sufficient to achieve this objective.

Table 45: Prudential requirements and supervision of credit intermediaries – Impact on main stakeholders

	Consumers and society	Credit intermediaries	Creditors	Member States
2.1: Do nothing	0	0	0	0
2.2: Principles-based requirements	✓✓	×	✓	×/0
2.3: Specific requirements	✓✓✓	××/×	✓✓	×/0
2.4: Introduce EU level supervision	✓	0	✓	×/0

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive impact
××× (Strong) – ×× (Moderate) – × (Weak) negative impact – 0 neutral impact

Principles-based rules and specific rules are expected to have similar positive impacts in reduction of default levels and therefore will have a positive impact on consumers. However as prudential requirements and supervision will set the same level requirements in all Member States under the option of specific rules, this option is expected to entails the largest potential in terms of reduction of defaults.

For credit intermediaries Option 2.3 will generate more costs then Option 2.2 to adapt their processes to new rules in place. In the case of specific rules, all credit intermediaries will need to adapt their process to comply with the new rules, while in Option 2.2 only in those Member States with currently no rules in place, there will be new rules which will generate some compliance costs. In terms of benefits, specific rules will facilitate market entry for credit intermediaries. This should also bring new business opportunities for creditors using credit intermediaries as a gate to other countries' markets.

For Member States, the main economic impact of the different options appears equal in terms of improving the market stability by an improved supervision, especially in markets where currently no such supervision is conducted. However, in those Member States, the introduction of supervision will create some operational costs for public authorities. These costs will be slightly higher for specific rules then for principles-based rules, as in the latter, only a limited number of Member States will need to adapt their rules.

Table 46: Prudential requirements and supervision of credit intermediaries – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 2.1	Option 2.2	Option 2.3	Option 2.4
Consumer/social benefits:				
reduction in defaults	0	19.9–51.0	25.5–59.5	0–19.8
Provider benefits	0	not quantified	not quantified	
Total EU costs (million EUR)	Option 2.1	Option 2.2	Option 2.3	Option 2.4
Provider costs:				
one-off	–	–	–	–
recurring	–	17.7	22.7	–
Member State costs:				
one-off	–	0.5	0.6	0.6
recurring	–	1.6	2.0	0.1

5.9. Assessment of the policy instruments

Due to the diversion in stakeholders interest and the existence of information asymmetries between consumers and credit intermediaries, a self-regulatory initiative is expected to have limited or no impact on addressing regulatory gaps on authorisation and registration and the introduction of prudential requirements and supervision of credit intermediaries. Second, it is unclear how a self-regulatory initiative can be designed and endorsed by market participants.

5.9.1. Non-binding Community instrument

A Communication to stakeholders in the credit intermediaries market is unlikely to have a stronger effect than proposing self-regulatory measures.

Similarly, a Commission Recommendation to Member States for the setting rules for the authorisation and registration of credit intermediaries is very unlikely to have impact in due to its non-binding character. Similarly, the introduction of prudential requirements and supervision of them cannot be enforced by self-regulatory measures. Therefore, the opening up of the market for credit intermediaries in Member States who currently do not allow them on the market is unlikely to happen.

5.9.2. Binding Community instrument

The introduction of binding community instrument is expected to be more efficient in addressing regulatory gaps for the authorisation, registration and prudential requirements and supervision of credit intermediaries. Only a binding Community instrument can ensure that the recommended principles-based rules are put in place in Member States which currently do not have such an authorisation registration and supervision process or which do not allow for credit intermediaries to enter the market.

In general, the Commission has the choice between a directive and a regulation as a binding policy instrument. A directive has, on the one hand, the advantage of allowing for a more flexible approach, enabling both minimum and maximum harmonisation within the same instrument and thus is able to take into account the specificities of national markets. A minimum harmonisation directive would allow more flexibility to Member States than a maximum harmonisation directive, which would reduce the possibilities for Member States to gold plate. A regulation, on the other hand, theoretically allows achieving the highest level of harmonisation and standardisation in a shorter timeframe without the need for national transposition measures. It also would enable private enforcement by consumers and business alike, thus bringing the single market closer to the citizen.

Setting up a process for authorisation, registration and supervision does not appear to require full standardisation at technical level as national market characteristics should be taken into account due to the different levels of maturity and market share of credit intermediaries within the EU. This argues in favour of a directive rather than a regulation. While a directive approach with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national specificities of the market. It is therefore recommended to use the legal instrument of a directive for the authorisation, registration and supervision of credit intermediaries.

5.10. Impact on Community resources and impacts on third countries

The recommended option of creating principles-based rules for the authorisation, registration and the introduction of prudential requirements and supervision of credit intermediaries does not have any perceived impacts on European Community resources.

As already described above, the main social impacts relate to the reduction in defaults of mortgage loans sold by credit intermediaries. On the downside, introducing requirements for authorisation and registration and supervision of credit intermediaries may lead to more responsible behaviour which might make it more difficult for some consumers when applying for mortgage loans. However, this does not outweigh the benefits of fewer defaults.

As regards the environment, no impacts are expected.

With regard to the impact on third countries, the introduction of authorisation registration and supervision of credit intermediaries will not lead to discrimination as credit intermediaries from third countries willing to offer their services on the EU territory would need to comply with the same rules. If the proposed directive is extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway. Finally, no direct impact on other countries is to be expected.

5.11. Conclusion

The introduction of rules on authorisation and registration as well as on prudential requirements and supervision are expected to close the regulatory gaps in these areas and generate positive impacts on the market of credit intermediation. On the one hand, it is expected that these rules will increase legal certainty and facilitate market access for credit intermediaries in some Member States and on the other hand, it will increase consumer protection and reduce default levels in Member States without rules in place Therefore, the benefits will imply both increased consumers choice and reduction of default levels due to proportionate rules. Market forces and self regulatory efforts do not appear to be sufficient to promote a proportionate authorisation registration and supervisory process for credit intermediaries. In this context, it is strongly recommended to set principles-based rules for the authorisation and registration and prudential supervision of credit intermediaries by means of a directive.

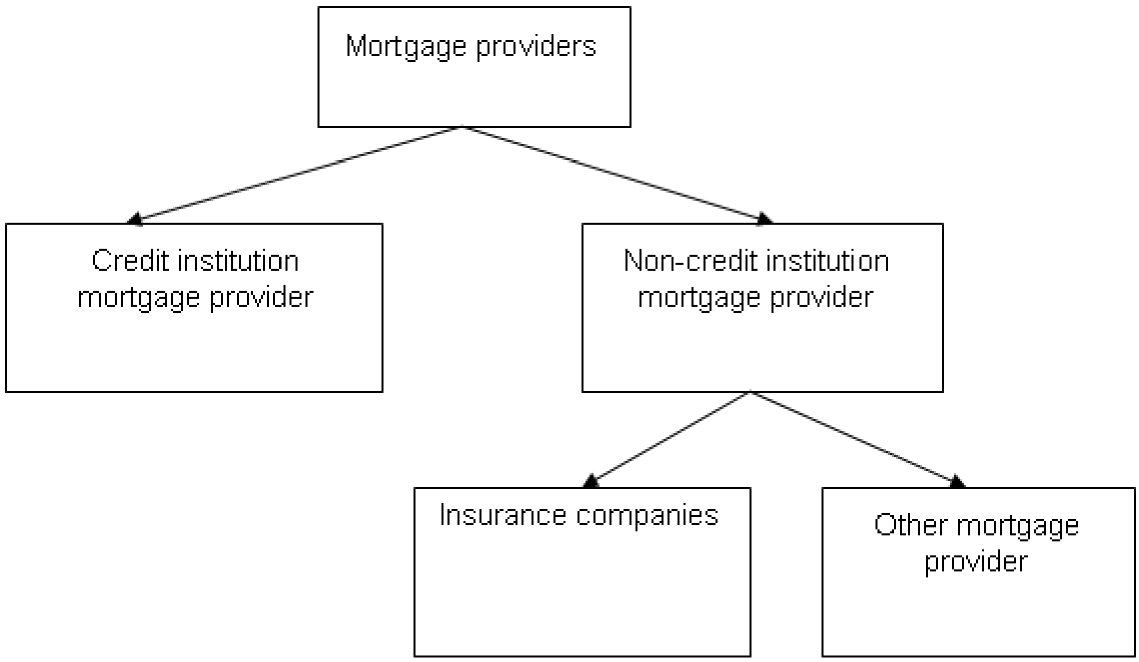
6. REGISTRATION, AUTHORISATION AND SUPERVISION OF NON-CREDIT INSTITUTIONS PROVIDING MORTGAGE CREDIT

6.1. Context

A creditor is defined in EU legislation as a natural and legal person who grants credit in the course of their trade, business or profession.[835] EU legislation[836] does not affect the right of Member States to limit, in conformity with Community law, the provision of mortgage credit to consumers to legal persons only or to certain legal persons. Therefore, the legal status of residential mortgage lenders depends on national legislation.

Mortgage lenders can be broadly divided in to two categories: credit institutions and non-credit institutions (hereafter referred to as NCIs).[837] According to EU legislation[838], a credit institution is defined as an undertaking whose business is to receive deposits or other repayable funds for the public and to grant credit for its own account. Credit institutions are regulated under the Capital Requirements Directive.[839]

Graph 8: Overview of mortgage lenders



Derived from the definition for credit institutions, NCIs can be defined as those undertakings active on the mortgage lending market that are not registered as credit institutions according

835 See footnote 254, Article 3(b).
836 See footnote 254, explicit statement of this in recital 15 for credit agreements covered by the directive.
837 The Commission is not aware of any natural persons providing mortgage credit at an appreciable scale in the EU.
838 Directive 2006/48/EC, Title I, Article 4(1).
839 Directive 2006/48/EC.

to domestic regulatory and supervisory frameworks.[840] NCIs can be further divided into two categories: insurance companies[841] providing mortgage credit and others. For the purpose of this exercise, the focus is on these other NCIs, however excluding further those institutions that fall within the mutual recognition of services within the meaning of Article 24 Capital Requirements Directive[842].

Authorisation of NCIs with the competent authorities can be defined as a process in which the competent authorities assess the soundness and properness of NCIs to operate on its market and in which the authorities allow them (or not) to provide services on the territory. During this process, the NCIs requesting authorisation supply information on[843]:

– the identification and address of the NCI and its management;

– the details of its shareholders and the whether the NCI itself has holding, direct or indirect, representing more than 10 % of the voting rights in other entities;

– details on professional qualifications of its management and its sales staff;

– details on its internal controls structure;

– details on the internal remuneration structure applied to its sales staff and management.

Registration of a NCI is the process in which the competent authorities inscribe a duly authorised NCI in a publicly available register of authorised NCIs. This ensures that consumers can identify if an entity is entitled to operate on the territory by enabling verification of the authorisation of the entity.

Prudential requirements aim to ensure that creditors limit their risk taking behaviour when lending mortgage credit and aim to contribute to the stability of the financial system. Prudential requirements include requirements such as professional indemnity insurance, initial and ongoing capital requirements as well as funding limitations. The *De Larosière report* on financial supervision defines supervision as "the process designed to oversee financial institutions in order to ensure that rules and standards are properly applied"[844] and "The prime

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840 This definition reflects the fact that Member States use different definitions of 'other repayable funds from the public' as well as regulate undertakings fulfilling only one of the two conditions set in Directive 2006/48/EC, Title I, Article 4 (1) as credit institutions.

841 Only in six Member States, insurance companies are allowed to provide mortgage loans as part of their main insurance business. These companies are regulated and supervised for this purpose. See footnote 66.

842 Article 24 of Directive 2006/48/EC provides for non-credit institutions that are: the subsidiary of a credit institution or the jointly-owned subsidiary of two or more credit institutions; and whose parent undertaking or undertakings are authorised as credit institutions in the Member State by the law of which the financial institution is governed and whose activities are carried on within the territory of the same Member State, can subject to two additional conditions, benefit from the 'mutual recognition of services' or in other words, the EU Banking passport. These entities are considered out of scope of this impact assessment.

843 Based on *Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation*, Article 12, Information provided by the insurance intermediary, see http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002L0092:EN:NOT.

844 *De Larosière report on Financial Supervision*, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

objective of supervision is to ensure that the rules applicable to the financial sector are adequately implemented, in order to preserve financial stability and thereby to ensure confidence in the financial system as a whole and sufficient protection for the customers of financial services. One function of supervisors is to detect problems at an early stage to prevent crises from occurring."[845] "In addition, supervision must ensure that all supervised entities are subject to a high minimum set of core standards."[846] Effective supervision of market players is necessary to ensure that players observe the rules in place.

In the US, mortgage market participants with no federal supervision were responsible for originating more than 50 % of sub-prime mortgages,[847] which led to the worldwide economic and financial crisis. Consequently, the *De Larosière report* on financial supervision, "it is advisable to look into the activities of the 'parallel banking system'". The group considers "that appropriate regulation must be extended, in a proportionate manner, to all firms or entities conducting financial activities which may have a systemic impact". The group underlines the importance of this "since such institutions, having no deposit base, can be very vulnerable when liquidity evaporates – resulting in major impacts in the real economy".[848]

6.2. Overview of the legislative framework

Available information suggests that registration, authorisation and supervision requirements for NCIs vary across Member States.[849] Of the twenty one[850] Member States[851] allowing NCIs to offer mortgage credit within their territory, fourteen[852] require that NCIs undertake some form of notification, registration or authorisation in order to provide residential mortgage loans. Six Member States[853] do not however require any notification, registration or authorisation. Bulgaria only requires notification within 14 days of commencing operation. In principle, general conduct of business rules, including consumer protection laws, apply in all Member States.

The market share of NCIs in the Member States' national mortgage markets in 2007 is small compared with the market share of fully-fledged credit institutions as shown in Annex I, Section 3.2.[854] NCIs in the United Kingdom have the highest market share (12 %), followed by the Netherlands (10 %) and Romania (9.7 %). In the six Member States[855] that do currently not require any notification, registration or authorisation for NCIs, only a marginal share of the lending market is taken by those lenders. According to the limited information available

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845 See footnote 844.

846 See footnote 844.

847 *Blueprint for a modernized regulatory financial structure*, Department of the Treasury, March 2008, http://www.ustreas.gov/press/releases/reports/Blueprint.pdf.

848 See footnote 544.

849 See footnote 66.

850 Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Ireland, Spain, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, the Netherlands, Poland, Romania, Slovenia, Finland, Sweden and the United Kingdom.

851 Twenty Member States allow both domestic and foreign non-credit institutions, while Poland only allows a special type of domestic non-credit institution.

852 Belgium, Bulgaria, Ireland, Spain, Italy, Lithuania, Luxembourg, Hungary, Malta, the Netherlands, Romania, Slovenia, Sweden and the United Kingdom.

853 Czech Republic, Denmark, Estonia, Cyprus, Latvia and Finland.

854 See footnote 66. It should be noted that of 20 Member States allowing non-credit institutions, only 15 Member States were able to provide data on the estimated market share of non-credit institutions.

855 See footnote 353.

on this issue[856], cross-border provision[857] of residential mortgage loans through NCIs appears to be very limited. The main barriers identified for cross-border activity of NCIs are not specific to their status but rather barriers related to differences in the regulatory and supervisory framework for financial services in the EU.

Funding mechanisms available to NCIs also differ across the Member States. They include own shareholder funds, loans from credit institutions and financial institutions, general debt securities, mortgage backed securities and mortgage covered bonds.[858] Funding mechanisms available to NCIs serve as a prudential requirement, limiting the amount of mortgage credit that can be offered to consumers. In most countries which allow NCIs to operate on their markets, funding sources are limited[859]. Twelve Member States[860] only allow for 'own shareholder funds' and 'loans from credit institutions'. Two Member States[861] allow for 'shareholder funds', 'loans from credit institutions' and 'general debt securities' but not 'covered mortgage bonds'. Three Member States[862] allow NCIs to use in addition 'mortgage backed securities' and 'covered bonds'. The main motivations to exclude funding sources other than shareholders own funds and loans are[863]:

– the need to protect consumers, as NCIs are not included within the deposit protection schemes;

– the need to mitigate the financial stability risk, because NCIs are subject to lower supervision rules;

– the need to facilitate the entry in the market of these operators; other funding sources would oblige authorities to request more stringent prudential and supervision requirements.

Table 47: Overview of current legal situation of NCIs within EU Member States[864]

Country	Legal, judicial or self-regulatory rules regarding registration, authorisation and supervision of NCIs
Austria	Non credit institution lenders (NCIs) are not allowed to provide residential mortgage loans. In order for institutions to provide mortgage loans, they must be regulated and supervised as mortgage institutions according to Austrian Federal Banking Act 532/1993 (as amended).
Belgium	NCIs must be registered and authorised 'Inscription' from the Belgium Banking Finance and Insurance Commission (CBFA) according to Art. 43 & 43bis, Law in Relation to Mortgage Credit, 1992. NCIs are a type of 'Mortgage Firm' and are supervised by the CBFA but they are not currently subject to prudential supervision. The Law in Relation to Mortgage Credit, also specifically defines 'Mortgage Firm' and 'Mortgage Credit' in chapter 1, Art. 2. Foreign NCIs must also seek 'Inscription' and registration.
Bulgaria	NCIs must 'notify' the Bulgarian National Bank (BNB) according to the Law on Credit Institutions of 21 July 2006, of their intention to commence operations. The Law on Consumer Credit, 2007 which regulates advertising applies to NCIs. No distinction between domestic and foreign NCIs.

856 See footnote 66.
857 Cross-border provision refers to the supply of mortgages through local presence (e.g. branches, subsidiaries, mergers and acquisitions); through direct distribution channels (e.g. via telephone or the internet); or through local intermediaries (e.g. brokers).
858 See footnote 66.
859 See footnote 66.
860 These include Bulgaria, Czech Republic, Denmark, Spain, Italy, Cyprus, Latvia, Luxembourg, Hungary, Malta, Romania and Slovenia. See footnote 66.
861 These include Lithuania and Finland. See footnote 66.
862 These include Estonia, Poland and the United Kingdom. See footnote 66.
863 See footnote 66.
864 See footnote 66.

Cyprus	No specific regulation or supervision of NCIs, the Cypriot Banking Act of 1997 provides this framework for credit institutions only. Therefore there is no distinction between domestic and foreign NCIs. Consumer Protection Law, 2001 does apply to NCIs to a maximum value of EUR 85 000.
Czech Republic	No specific regulation or supervision of NCIs, the Act on Banks, 1997 provides this framework for credit institutions only. Therefore there is no distinction between domestic and foreign NCIs.
Denmark	No specific regulation or supervision of NCIs, the Financial Business Act, 2006 provides this framework for credit institutions only. Therefore there is no distinction between domestic and foreign NCIs.
Estonia	No specific regulation or supervision of NCIs, the Credit Institutions Act, 1999 provides this framework for credit institutions only. Therefore there is no distinction between domestic and foreign NCIs. The Law of Obligations Act, Art 402 & 403 apply consumer protection rules to all consumer credit loans including mortgage loans by NCIs.
Finland	No specific regulation or supervision of NCIs, the Act on Credit Institutions, 2007 provides this framework for credit institutions only. Therefore there is no distinction between domestic and foreign NCIs. The Consumer Credit Act, 1995 Chapter 7 applies to all consumer credit loans including the activities of NCIs.
France	NCIs are not allowed to provide residential mortgage loans. It is necessary for institutions to be registered as credit institutions in order to provide mortgage loans according to Article L311–1, L511–11 and L511–5 of the Financial and Monetary Code.
Germany	NCIs are not allowed to provide residential mortgage loans. The German Banking Act specifies that businesses involved in mortgage lending are credit institutions and they must therefore be registered, authorised and supervised as credit institutions.
Greece	NCIs are not allowed to provide residential mortgage loans. All institutions that provide residential mortgage loans must be registered, authorised and supervised as credit institutions by the Bank of Greece (article 4 of the Law 3601/2007).
Hungary	Employ a different definition of 'Financial Institutions' in the Act on Credit Institutions and Financial Enterprises 1996 as compared to the Capital Requirements EC Directive 2006/48. The Hungarian definition includes Credit Institutions and Financial Enterprises of which NCIs are considered to be included and must therefore be registered and authorised by the Hungarian Financial Supervisory Authority. There is no distinction between domestic and foreign NCIs.
Italy	The Banking Law, 1993 provides for the authorisation, regulation and supervision of NCIs, which are called 'Financial Intermediaries' in Italian law. The Bank of Italy, holds a register onto which NCIs are entered, they may be entered on the general register or on a special register which may dictate special conditions in relation to their permissible activities and more stringent supervision.
Ireland	The Markets in Financial Instruments and Miscellaneous Provisions Act, 2007 amending the Central Bank Act 1997, designates the Financial Regulator as the body responsible for the authorisation and supervision of NCIs which are divided into (1.) retail credit firms, as prescribed by Consumer Credit Act, 1995 (as amended) (2.) home reversion firms, describes where a consumer agrees to sell a share of their home in return for a set price. The Financial Regulator can impose conditions regarding authorisation on NCIs. In the case of foreign NCIs (foreign retail credit or home reversion firms) the Financial Regulator will have regard to the requirements imposed on the firm by its equivalent home country regulatory authority and may exchange information with that authority.
Latvia	No specific regulation or supervision of NCIs, the Credit Institution Law, 1996 provides this framework for credit institutions only. Therefore there is no distinction between domestic and foreign NCIs. The Consumer Rights Protection Act, 2001 apply consumer protection rules to all forms of lending including NCIs.
Lithuania	Employ a different definition of 'Financial Institution' in the Law on Financial Institutions, 2002 as compared to the Capital Requirements EC Directive 2006/48. The Lithuanian definition includes Financial Undertakings which encompasses NCIs and Credit institutions, which are all regulated under the Law on Financial Institutions, 2002. NCIs are not supervised only Credit institutions are subject to further supervision by the Central Bank of Lithuania. No distinction between domestic and foreign NCIs.
Luxembourg	The Law of the 5 April 1993 on the financial sector defines a special form of credit institution called a 'Mortgage Bank'. NCIs must be registered and authorised by the Commission de Surveillance de Secteur, as a 'professional of the financial sector' to undertake mortgage lending.
Malta	The Financial Institution Act, 1994 provides the regulatory and supervisory framework for NCIs, who must be registered and authorised as 'Financial Institutions' with the Malta Financial Services Authority to undertake mortgage lending. No distinction between domestic and foreign NCIs.
Netherlands	The Financial Supervision Act, Chapter 2.60 provides NCIs must seek registration and authorisation in the form of a license from the Netherlands Authority for the Financial Markets to undertake mortgage lending. No distinction between domestic and foreign NCIs.
Poland	Foreign NCIs are not allowed to provide residential mortgage loans. Only a certain type of domestic NCIs, 'Credit Unions' can provide mortgage loans, according to the Credit Unions Act 1995.
Portugal	NCIs are not allowed to provide residential mortgage loans. Institutions that provide residential mortgage loans must be registered as credit institutions according to General Regulations on Credit Institutions and Financial Societies Law 1/2008.
Romania	NCIs must be registered as 'Non-bank Financial Institutions' or 'Specially Licensed Institutions' with the National Bank of Romania according to Government Ordinance No 28/2006. No distinction between domestic and foreign NCIs.

Slovakia	NCIs are not allowed to provide residential mortgage loans. Institutions that provide residential mortgage loans must be registered as banks (credit institutions), in accordance with Article 2 and Articles 67 to 88 of the Act on Banks (Act number 483/2001).
Slovenia	NCIs are regulated and supervised under the Consumer Credit Act, 2000 Art. 2 and Art 22(1) which provides a regulatory and supervisory framework. No distinction between domestic and foreign NCIs.
Spain	The Legal Framework for Financial Credit Entities 1996 provides for the registration and authorisation of a special class of credit institution, a Financial Credit Entity which includes some types of NCIs. NCIs which are not a Financial Credit Entity are subject to no regulation or supervision. No distinction between domestic and foreign NCIs.
Sweden	The Swedish Financial Supervisory Authority regulates NCIs; they are subject to disclosure requirements and inspection under certain conditions. Under the Obligations to Notify Certain Financial Operations Act, 1996 NCIs must notify the authority of the activities they plan to undertake. NCIs are however not supervised. No distinction between domestic and foreign NCIs.
United Kingdom	Financial Services Authority regulates and supervises the activity of NCIs and they must be registered and authorised as non-deposit taking institutions. No distinction between domestic and foreign NCIs.

Source: London Economics, September 2008

6.3. Problem description

6.3.1. Authorisation and registration gaps

Authorisation and registration requirements, such as professional indemnity insurance or professional qualifications, are a means for public authorities to control which players are active on the market as well as to impose certain conditions and qualifications necessary for the business they engage in ensuring that they are 'fit and proper' to operate on the market. Furthermore, authorisation and registration requirements form a prerequisite for effective supervision of market players which in turn is necessary to ensure that players observe rules in place. Consequently, gaps in or the absence of any regulation of the authorisation and registration of NCIs have the potential to create wider market or systemic failure.

Although mortgage mis-selling practices by NCIs have been less prevalent in the EU than in the US[865], where widespread mis-selling contributed to the sub-prime crisis, similar regulatory and supervisory gaps, and the potential and corresponding risks of such practices exist in the EU[866]. In this respect, several regulatory gaps have been identified which have the potential to cause widespread market failure.

First of all, the existing regulatory framework shows that these regulatory gaps exist. As stated above, six Member States[867] allowing the operation of NCIs have no authorisation and registration requirements, and requirements vary widely among the other Member States with regulation in place. In these cases, NCIs participate in the mortgage market, lending funds based on 'other funding' sources than deposits. Therefore, NCIs can be considers as being part of the 'parallel banking system' and may have a systemic impact on the mortgage market when their market share increases.

865 *Mortgage brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 percent of subprime mortgages in the United States*, the Treasury Blueprint for a modernised financial regulatory structure, 31.3.2008. For a description of the policy measures taken in the US to reform the mortgage origination process, see http://www.treas.gov/press/releases/reports/q4progress%20update.pdf.

866 In the course of the financial turmoil and considering the role the Spanish intermediaries played in the mortgage market, the Spanish government reviewed the law and issued a more stringent regulatory and supervisory regime: http://www.bde.es/clientebanca/entidades/otros/intermediarios.htm. Furthermore the FSA indicated amidst the financial crisis that there are considerable risks and gaps in the mortgage intermediary sector, http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2008/1112_lt.shtml.

867 See footnote 353.

Second, evidence shows that these gaps have the potential to create market or systemic failure. While it could be argued that the market share of NCIs in the six Member States currently not having any registration and authorisation requirements in place is currently low[868] and therefore no such requirements are required, the potential for irresponsible behaviour and a corresponding impact on financial stability cannot be underestimated. The example of the United Kingdom (see Box 2) has shown that actual market situation within a Member State can change quickly (both rapid market entry and exist) with dramatic effects for the mortgage market. The example of Australia as illustrated in Box 2 also shows that this situation is not unique.

Box 1: UK market review on non-bank lenders

The UK Financial Services Authority mortgage market review[869] showed evidence of problems regarding commercial practices of NCIs (known as non-banks in the United Kingdom) competing aggressively on the market, increasing their market share from 4 % in 2000 up to 15 %[870] in 2008.

For the purpose of their analysis, the Financial Services Authority defined 'high-risk lending' as they combined up of four high-risk borrower or product characteristics which include: a high loan-to-value; absence of income verification, lending with credit impaired borrowers and lending for the purpose of debt consolidation. Based on their analysis, non-banks were particularly present in the area of high-risk lending in comparison with credit institutions.

The expansion of non-bank lenders within the United Kingdom was particularly achieved by pursuing new, higher-risk market segments that previously only enjoyed limited access to mortgages[871]. Particularly consumers whose inability to repay was foreseeable were targeted based on a business model of 'equity lending', that is built specifically around consumers with impaired credit histories, who are unlikely to be able to repay the mortgage but have equity in their properties on which the lender could ultimately rely[872].

An additional concern for the Financial Services Authority is that in 2009, the majority of non-bank lenders pulled out of the market and are no longer lending. Quick entry and exit of a significant supply share had a particular damaging impact in the United Kingdom where borrowers are remortgaging on average every four to five years and depend on the continued availability of mortgage deals.

Box 2: Australian Mortgage market and NCIs

The structure of the mortgage market in Australia has changed significantly over the past decade. Before the crisis struck the global economy NCIs managed to gain a systematically important market share. In particular, since the mid 1990s, the share of outstanding loans accounted for by non-credit institution lenders has increased from less than 2 % to around 10 % in mid 2007[873]. The market share of newly originated mortgage credits by non-banks

868 Market share of NCIs is below 5 % in Czech Republic, Estonia, Cyprus and Finland as shown in Annex I, Section.3.2, information for Denmark is not available.

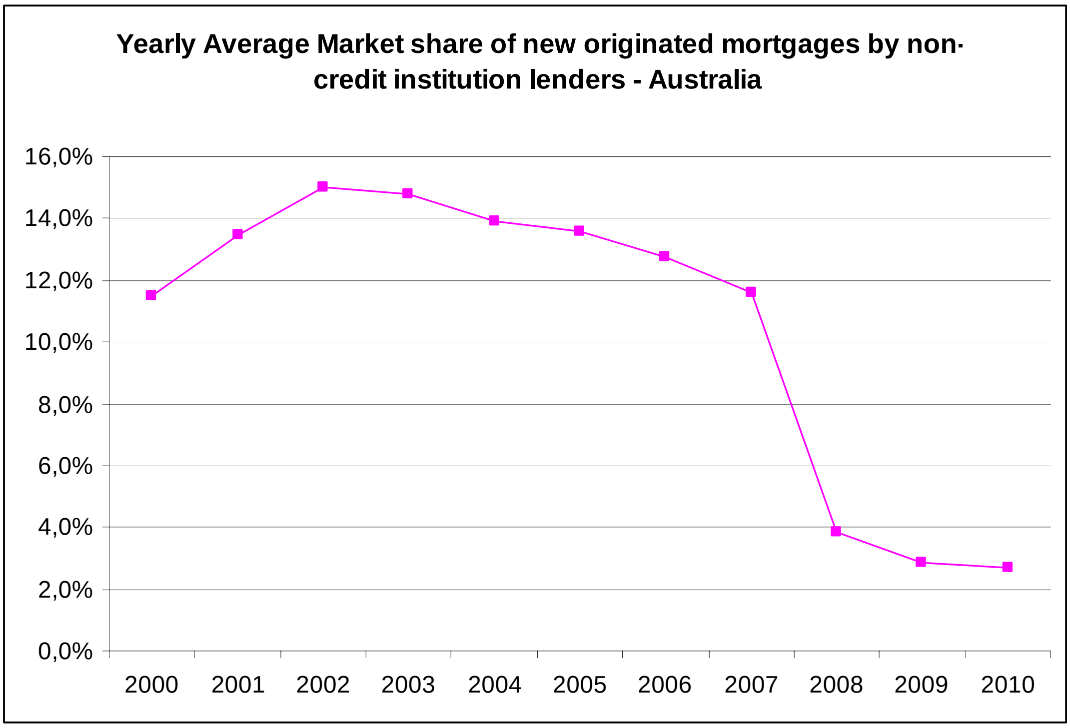
869 See footnote 246.

870 See footnote 246.

871 See footnote 246. A similar pattern was seen in Ireland prior to the regulation of the sector, see http://www.independent.ie/business/irish/watchdog-to-police-subprime--market-1076842.html.

872 See footnote 246.

during the same period was above 12 % until end 2006.[874] This shows that before the financial crisis struck the global markets, NCIs managed to gain a significant market share of the Australian market and could have systematic impacts.



Source: Australian Bureau of Statistics, 5609.0 – Housing Finance April 2010[875]

Since the financial crisis hit the global economy in the middle of 2007 the situation significantly changed as funding sources for non-credit institution lenders dried up[876]. As a non-bank sector largely dependent on funding via the capital markets corresponding production of mortgage credit decreased considerably, stabilising in the period 2009–2010 at around 2.6 %.

Mortgage Lending by NCIs show higher levels of arrears rates

According to the Financial Stability Review of the Reserve Bank of Australia[877] the arrears rates on housing loans in Australia have increased since the unusual low levels in 2005 both for credit institutions and NCIs. However, the arrears rates on loans issued by NCIs are significantly higher then those of credit institutions as shown in the figure above. For example, the arrears rate of full-documentation loans originated by NCIs is higher and has increased by more than that for equivalent loans originated by banks. Arrears on mortgage

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873 *RBA Submission to the Inquiry into competition in the banking and non-banking sector*, Reserve Bank of Australia, p. 3, Non-banking sectors, http://www.rba.gov.au/publications/submissions/inquiry-comp-bank-sect.pdf.

874 See footnote 873.

875 http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5609.0Main+Features1Apr%202010?OpenDocument

876 *Non-bank lenders, ready to rumble*, The Adviser, January 2010, http://www.theadviser.com.au/features/cover-stories/3274-non-bank-lenders-ready-to-rumble.

877 *Financial Stability Review*, Reserve Bank of Australia, March 2009, http://www.rba.gov.au/publications/fsr/2009/mar/html/house-bus-bal-sheet.html.

loans on non-bank lenders increased from 0.2 % end 2003 up to 1.0 % in 2008, while mortgages originated by banks was lower at 0.4 %. According to the same report, differences in arrears rates across loan types also reflect differences in credit standards across lenders. This is an indication that in Australia, NCIs have been pursuing more risky consumer segments.

Third, the fact that mortgage lenders, which are not authorised and registered, can be active on mortgage markets could translate into low consumer confidence. This is due to fact that potential borrowers might not be able to differentiate between, on the one hand, non-registered and authorised entities, and therefore non-regulated and non-supervised lenders and, on the other hand, registered and authorised entities, which are therefore regulated and supervised. As a result, there is a higher risk that borrowers purchase an unsuitable product as the non-registered and authorised lender might not have the necessary knowledge and qualifications to assess correctly the creditworthiness of the borrower and give the necessary information or explanations. Similarly, different authorisation and registration requirements in Member States could lead to different levels of consumer protection across Member States. For instance, while Bulgaria has a requirement for notification, it does not impose any requirements in terms of professional indemnity insurance or professional qualifications. Therefore, borrowers could be led to take out the wrong mortgage credit for their needs and financial circumstances due to the lack of knowledge of employees of the NCIs and might subsequently be unable to collect compensation because there is no indemnity insurance which would cover such claims.

Finally, the fact that there are markets in which some mortgage lenders are required to be authorised and registered and some markets where they are not, creates an unlevel playing field between institutions. Credit institutions providing mortgage credit will face higher costs for engaging in mortgage credit than NCIs. There is therefore a risk of regulatory arbitrage. This patchwork is further exacerbated at the EU level where the registration and authorisation requirements vary considerably.

6.3.2. Prudential and supervisory gaps

Three different approaches exist[878]:

– A first set of Member States[879] requires that all mortgage lenders are credit institutions.

– A second set of Member States[880] in which NCIs play a role in the mortgage market, have specific legislation for mortgage lending by NCIs.

– A third set of Member States[881], in which NCIs have a small market share in the mortgage market, there is no regulation or supervision in place.

Furthermore, while Article 20 of the Directive on Consumer Credit[882] requires that creditors (both credit institutions and NCIs) are supervised by a body or authority independent from

[878] See footnote 66.
[879] Germany, Greece, France, Austria, Portugal and Slovakia.
[880] See footnote 852.
[881] See footnote 353.
[882] See footnote 254.

financial institutions, this provision does not cover mortgage credit. Consequently, there is an absence of EU-wide prudential requirements and supervision for NCIs.

First, the lack of registration or authorisation requirements in several Member States[883] means that authorities have little scope for supervision of NCIs' activities or sanctions for misconduct. This has the potential to create an uncompetitive environment in which misconduct, excessive risk taking is not held to account[884]. In those Member States with no prudential requirements or supervision in place, the potential for irresponsible lending to materialise continues to exist. NCIs acting without being subject to supervisory oversight may raise questions of financial stability, as regulatory and supervisory authorities may not be in the position to review whether they are involved in the provision of high-risk credit. It is widely recognised that the sales of home loans by NCIs was a significant contributing factor to the outbreak of the financial crisis in the US[885]. While the size of the market as well as the number of unregulated credit intermediaries in the EU is by no means on a comparable level to the US, gaps in the regulatory framework do exist, thus the potential for consumer detriment and low consumer confidence, as well as financial instability exist.

Second, those Member States[886] which allow NCIs to operate on their markets, in general have lower capital requirements in place for NCIs than for credit institutions.[887] It will therefore be easier for an entity to enter the market than in those Member States which require all mortgage lenders to be a credit institution. This leads, on the one hand, to more lenders competing in the markets where NCIs are regulated, resulting in more competition, more innovation and more consumer choice. On the other hand, the lack of prudential standards and/or ongoing requirements for NCIs can lead to an overly fluid and unreliable business sector as well as creating an unlevel playing field vis-à-vis credit institutions. The UK mortgage review (see Box 2 above) has shown that even in Member States with provisions regarding registration and authorisation of NCIs in place, problems can arise when non-credit institutions aggressively enter the market, pursuing high-risk strategies and afterwards rapidly pulling out, hereby destabilising the mortgage market[888].

Third, differences in regulatory and supervisory frameworks across Member States lead to additional costs when operating cross-border[889]. According to the London Economics study on NCIs, these additional costs result from the need to employ indigenous staff to understand and conform to the legal frameworks across different Member States which are operating cross-border, they need to know which products are allowed in Member States arising from unharmonised authorisation processes, and they need to make 'back-office' adaptations of software to conform local regulations across Member States. They also need to be aware of differences in potential margins of mortgage products allowed on the market and differences in assets that different Member States national regulations permit for use in collateralising a

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883 See footnote 353.

884 In recent years mortgage brokers and lenders in the US with no federal supervision originated a substantial portion of all mortgages and over 50 % of subprime mortgages in the United States. *Treasury Blueprint for a modernised financial regulatory structure*, 31.3.2008, see http://www.ustreas.gov/press/releases/reports/Blueprint.pdf.

885 See footnote 808.

886 Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Ireland, Spain, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, the Netherlands, Romania, Slovenia, Finland, Sweden and the United Kingdom.

887 See footnote 66.

888 See footnote 246, points 3.48 and 3.49.

889 See footnote 66.

mortgage loan[890]. Facing additional costs to operate cross-border is likely to result in less NCIs willing to do so and thus restricts competition within the single market.

Finally, the regulatory barriers described are compounded when considering cross-border business. Cross-border activity is extremely limited at present[891], partly due to the barriers NCIs face when engaging in cross-border business: the regulatory patchwork described above can inhibit a business's decision whether to engage in cross-border business as can the different conduct of business rules. This is in sharp contrast to credit institutions that can avail of passporting opportunities to take advantage of the single market.[892]

6.3.3. Summary of problems and consequences

Table 48: Problems and consequences for stakeholders

Problem	Consequences
Registration and authorisation gaps Prudential and supervisory gaps	**Risk of consumer detriment and reduced consumer mobility** – Risk of low consumer confidence in NCIs => Consumers purchase a product which is inappropriate for them or unnecessary => risk of inability to keep up with payments => risk of overindebtedness and foreclosures => reduced consumer confidence => if practices are widespread, risks to financial and economic stability **Missed opportunities for NCIs** – Economic and legal barriers to entering other markets => Missed opportunities for cross-border business => Restricted competition in the single market **Unlevel playing field between market actors** – Unlevel playing field between credit institutions and NCIs – Uncertainty in or lack of confidence in the regulation of NCIs, particularly those operating in another Member State => Restricted competition in the single market

6.4. Stakeholder views

Commission services conducted a public consultation on the Study on the role and regulation of NCIs in EU mortgage market in 2009.[893] A total of 12 written responses were received. Some feedback on the role of NCIs was however received in the consultation on the Green Paper on Mortgage Credit in 2005.[894] These latter contributions should however be treated with caution as it was prior to the financial crisis.

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890 See footnote 66.

891 See Annex 1, Section 3.2.

892 *Directive 2000/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions*, Article 23.

893 See http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm and http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/non-credit/feedback_en.pdf.

894 See http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm and http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/feedback_gp-en.pdf.

6.4.1. *Consumers*

No consumer responses were received on the specific consultation on the Study on the role and regulation of non-credit institutions in EU mortgage market in 2009.[895] However, during the consultation on the Green Paper on Mortgage Credit in the EU[896], consumers supported expanding the number of mortgage lenders entering the market as they considered that this would improve competition on the market, resulting in more consumer choice and better prices for consumers[897].

6.4.2. *Creditors*

Responses to both the Green Paper on Mortgage Credit in the EU[898] and the public consultation on the report on NCIs showed that views of creditors are mixed.

First of all, responses the Green Paper on Mortgage Credit in the EU[899] suggested that there is a (small) majority of industry stakeholders who believe NCIs should be allowed to provide mortgage credit. Some industry stakeholders were further of the opinion that NCIs authorised in one EU Member State should automatically receive authorisation in other Member States by means of a passport. Other industry stakeholders emphasised the need for a level playing field between all mortgage lenders in terms of regulation, registration and supervision.

During the consultation on the Study on the role and regulation of NCIs in EU mortgage market[900], most contributors highlighted the need for some control by regulators for NCIs. Views were however divided on what would be an adequate level of regulation. While the majority of the contributions advocated addressing the issue based on the principle 'same business, same risks, same rules' in order to ensure a level playing field between all mortgage lenders in the EU, others were in favour of a differentiated approach between creditors according to their potential risks to the functioning of the financial system and to depositors' protection. Respondents agreed however that the same conduct of business and consumer protection rules should apply to all lenders, regardless of their status or their method of funding.

There were also different views from responding industry stakeholders on whether there is a case for action at the EU level A majority of responses dealing with this issue believe that no regulation of NCIs at the European level is needed because of the diversity of the roles played by NCIs within the respective national markets and the small market share of NCIs. Rather, effective regulation on the national level would be the appropriate way forward. Others were however in favour EU intervention – irrespective of the current level of market shares – because of the high potential risk that loopholes in the regulation can represent for the whole financial community as illustrated by the current financial crisis. Respondents of the public consultation on Study on the role and regulation of NCIs in EU mortgage markets pointed out that the lack of uniform regulation and supervision on NCIs could pose problems where NCIs

[895] See footnote 367.
[896] See footnote 367.
[897] See footnote 367.
[898] See footnote 367.
[899] See footnote 367.
[900] See: *Feedback on comments received on the study on the role and regulation of non-credit institutions in the EU Mortgage Markets*, p.°4, http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/non-credit/feedback_en.pdf.

engaging in cross-border lending only need to notify authorities in the host country, as this could hinder the effective control of fulfilment of national requirements. In this respect, a passport should not lead to regulatory arbitrage. Furthermore, it has been underlined that the main barriers identified in the study for cross-border activity of NCIs are not specific to their status but rather barriers related to the structure of the markets in the EU.[901]

6.4.3. *Member States*

Reponses by Member States on the Green Paper on Mortgage Credit in the EU[902] highlighted that opinions are mixed on this topic[903]. Those Member States which are supportive of allowing NCIs to be active on the mortgage market usually already had some regulation in place allowing them to operate on the national territory. These Member States support the idea that if NCIs were to be allowed, it must be ensured they are regulated. Other Member States were however of the view that mortgage lending is best undertaken by credit institutions.

Only two Member States[904] commented on specific consultation on the Study on the role and regulation of NCIs in EU mortgage markets, and that was in order to clarify the national state of play of their legislative framework and market situation.

6.5. Objectives

6.5.1. *General objectives*

– To create an efficient and competitive Single Market for consumers, creditors and credit intermediaries with a high level of consumer protection by fostering:

  – consumer confidence;

  – customer mobility;

  – cross-border activity of creditors and credit intermediaries;

  – a level playing field.

– Promote financial stability throughout the EU by ensuring that mortgage credit markets operate in a responsible manner.

6.5.2. *Specific objectives*

Ensure appropriate regime for uptake, pursuit and supervision of NCIs

6.5.3. *Operational objectives*

– Ensure that all NCIs providing mortgage credit are appropriately registered, authorised, and supervised.

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901 See footnote 66.
902 See footnote 367.
903 See footnote 367.
904 Slovenia and Finland.

– Ensure that NCIs operate in a responsible way within the EU market.

– Ensure that there is a level playing field between NCIs and other market players.

6.6. Description of policy options

6.6.1. Options on authorisation and registration

6.6.1.1. Option 1.1: Do nothing

Doing nothing means that there are no initiatives taken at EU level to introduce rules regulating authorisation and registration of NCIs. The likely consequence of not intervening in a situation with no EU-wide rules on the authorisation and registration of NCIs implies that national rules, if they exist, will continue to apply.

6.6.1.2. Option 1.2: Principles-based requirements

Under this option, general principles will be issued at EU level in order to ensure that Member States have appropriate authorisation and registration of NCIs in place. EU-wide principles would enable Member States to determine the national standards and requirements for authorisation and registration of NCIs and set up a register. Member States will be required to determine national rules stipulating the basic conditions for NCIs to act as credit providers. This option could also, potentially, include enabling NCIs to operate in all Member States.

6.6.1.3. Option 1.3: Specific requirements

The Commission could propose specific rules for the authorisation and registration of NCIs. These specific rules could include.

– A requirement for Member States ensuring the authorisation of NCIs. This authorisation could require that NCI have an effective internal process for assessing compliance with all internal policies and procedures. This internal process could include regular audits of all critical processes, verification of the separation of duties and evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting automation systems.

– A requirement for Member States to set out a streamlined registration process.

– A requirement for Member States to set up and make public a central register of all authorised NCIs operating in the territory.

Furthermore, the competent authorities of the Member State could keep a register that interested parties can consult in order to verify whether the NCI is duly authorised.

6.6.1.4. Option 1.4: Introduction of a passport

Under the precondition that NCIs are adequately authorised, registered and supervised, this option sets out that rules will be established offering an EU passport for NCIs to provide services cross-border. This passport would entail that NCIs, which are duly authorised and supervised in their home Member States, will be able to provide services in the host

Member States under the supervision of the home Member State and without requiring further authorisation in the host Member State.

6.6.2. Options on prudential requirements and supervision

6.6.2.1. Option 2.1: Do nothing

Under this option, no action would be taken at EU level to introduce prudential requirements such as initial capital or ongoing capital for NCIs. Supervision remains the responsibility of Member States. EU Member States remain free to impose prudential requirements on NCIs and supervise them if they consider this appropriate.

6.6.2.2. Option 2.2: Principles-based requirements

For this option general principles would be established for Member States to ensure that NCIs are subject to proportionate prudential requirements. Member States shall decide on the appropriate prudential requirements such as adherence to a compensation scheme in order to protect consumers against negligence or malpractice by NCIs.

6.6.2.3. Option 2.3: Specific requirements

Under this option, specific rules will be established at EU level stipulating prudential requirements for NCIs. The specific rule would stipulate that NCIs are required to adhere to a compensation scheme covering the territories in which they offer services. In addition, Member States could be required to set up an ombudsman to ensure consumers can address complaints of malpractices by NCIs to an independent party. This option requires that rules are established at EU level stipulating that NCIs are supervised by the competent authorities and describe what technical aspects such as their operation, initial capital, own funds, conflict of interest and risks of credit lending have to be supervised by the competent authorities. This option will establish harmonised rules on the supervision of NCIs ensuring that they are adequately monitored within the mortgage market and that competent authorities can carry out inspections on the activities of NCIs and preventive action on a case by case basis.

6.6.2.4. Option 2.4: Introduction of EU level supervision

This option implies that an entity at EU level would develop binding technical standards and ensure coordinated supervisory activities in relation to NCIs. The EU authority would act as an overarching supervisor of all national supervisors and could take decision with regard to individual NCIs if deemed necessary. This supervisory task could be attributed to the European Banking Authority that is to be established.[905] National competent authorities could still monitor NCIs activities at national level.

6.6.3. Description of options for policy instruments

Each of the above options could be given effect through a variety of different policy instruments. These include industry self-regulation (Code of Conduct), Commission

[905] COM(2009)501, *Proposal for a regulation of the European Parliament and of the Council establishing a European Banking Authority*, see http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20090923/com2009_501_en.pdf.

Recommendation, a Communication and Community legislation in the form of a Regulation or Directive. The table below explores the feasibility of giving effect to each of our policy options through each of the available policy instruments:

Table 49: NCIs – Policy options versus instrument

Policy options: content vs instrument	Self-regulation	Recommendation	Communication	Directive	Regulation
Authorisation and registration					
1: Do nothing					
2: Principles-based requirements		X		X	X
3: Specific requirements		X		X	X
4: Introduction of an EU Passport				X	X
Prudential requirements and supervision					
1: Do nothing					
2: Principles-based requirements		X		X	X
3: Specific requirements		X		X	X
4: Introduction of EU level supervision				X	X

Doing nothing does not require the use of any policy instrument. A Communication would be unable to give affect to any of the abovementioned policy options: it is a tool used simply to communicate information to the Member States, in contrast to the rest of the instruments that, once adopted, operate to effect a particular change in the way things are done. Consequently, a Communication can already be disregarded at this stage. Self-regulation is also likely to be ineffectual in this instance. The nature of registration, authorisation and supervisory regimes are such that they involve a competent authority, usually a public one. To establish such powers a legal act would be required, either on a national or EU level. Consequently, self-regulation can also be discarded at this stage.

The following sections will assess the impact of the policy options and will describe which policy instrument is the most appropriate to use, as well as the underlying reasons for the choice.

6.7. Assessment of policy options

6.7.1. Options on authorisation and registration of NCIs

6.7.1.1. Option 1.1: Do nothing

<u>Effectiveness of policy option</u>

This option implies that existing discrepancies between Member States remain in terms of authorisation and registration of NCIs.

This option does not contribute to the objective of limiting consumer detriment as in six Member States, namely Cyprus, Czech Republic, Denmark, Estonia, Finland and Latvia, that do not require any authorisation and registration, NCIs remain outside scope of any regulation and can enter the market and offer mortgage credit to consumers without any requirements. A lack of authorisation and registration offers the potential for irresponsible lending and consumer detriment. If this practice became widespread, this could in the long run lead to negative effects on financial stability.

This option does not contribute to the creation of a level playing field between all NCIs operating within the EU. On the one hand, in six Member States (Austria, France, Germany, Greece, Portugal and Slovakia) the mortgage credit market remains reserved for licensed credit institutions, thus NCIs are not allowed to operate. On the other hand, in six Member States[906] NCIs could enter the market without any authorisation and registration. In the remaining Member States there is a patchwork of authorisation and registration requirements. This leads to an unlevel level playing field between enterprises willing to provide mortgage credit among Member States. It can also act as a deterrent to cross-border activity.

Impacts of policy option on stakeholders and efficiency

In case no action is taken, NCIs will benefit from the fact that they can easily enter the market and offer credit without being subject to regulatory requirements in six Member States[907]. On the other hand, in six Member States[908], NCIs are not allowed to offer their services without applying for a license of a fully fledged credit institution (in accordance with the Capital Requirements Directive[909]), even if they do not take deposits, limiting business opportunities for them. In addition, NCIs will be prevented from taking up cross-border opportunities as they will need to comply with 27 sets of national requirements[910] leading to increased compliance costs and reduced economies of scale. Different national legislations create competition distortions as similar businesses will be subject to various regulatory requirements.

For Member States with no rules on authorisation and registration in place, monitoring the credit market will remain difficult as some actors remain free to enter and leave the market without any notification.

For consumers, withholding NCIs from market entry in some Member States, limits the product offering, innovation and competition within the mortgage market and presents an obstacle to the creation of a real internal market for credit. However, in these Member States, consumer detriment will be limited due to the absence of market players that are generally not or less regulated. On the other hand, for consumers in Member States without any regulation on authorisation and registration of NCIs in place, risk of consumer detriment remains present.

6.7.1.2. Option 1.2: Principles-based requirements

Effectiveness of policy option

The introduction of principles-based standards for authorisation and registration of NCIs would address the problem or regulatory gaps in this field. Principles-based rules will ensure

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906 See footnote 353.

907 See footnote 353.

908 See footnote 879.

909 *Directive 2006/48/EC on the taking up and pursuit of credit institutions*, and *Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions*.

910 It should be noted that six Member States currently do not have any requirements: Czech Republic, Denmark, Estonia, Cyprus, Latvia and Finland.

that Member States stipulate minimum requirements for authorisation and registration, without prescribing how this should be done in too much detail, thus providing a degree of flexibility to Member States to take into account the characteristics of their national markets.

This policy option would bring about improvements and would contribute to the objective of limiting consumer detriment by setting up national rules stipulating the basic conditions for NCIs to operate on their territory. Under this option, Member States could determine national rules stipulating which minimum standards the NCIs should adhere to thereby increasing consumer protection. However as the EU rules remain 'principles-based', the level of consumer protection would not be at the same level in all Member States due to different national requirements. However, in the event that this option opens market entry to NCIs[911] where they previously did not exist, there is a risk of increased consumer detriment through irresponsible lending as well as the tendency for NCIs to enter and leave the market too quickly.

Similarly, NCIs seeking to operate cross-border will need to comply with different levels of requirements. According to the study on the role and regulation of NCIs in the EU mortgage market[912], the existence of multiple different legislative frameworks for NCIs is a major barrier preventing NCIs from operating cross-border[913]. Therefore, this measure will only facilitate cross-border activity to a limited extent. In addition, as principles-based rules may differ among Member States, not all NCIs will need to comply with the same rules and this may pose issues on the existence of a level playing field between all entities operating within the EU. However, as all NCIs would need to comply with national rules, this could improve the level playing field between creditors at national level, especially in those Members States which currently do not have NCI authorisation and registration requirements.

In the event that this option would also open up the market for NCIs in six Member States[914], this could bring larger choice in terms of creditors and innovative products for borrowers. Opening up the market to NCIs may increase slightly the number of lenders in the market and somewhat enhance competition, which could bring more choice and lower prices for consumers.

Impacts of policy option on stakeholders and efficiency

The main impacts of the introduction of principles-based rules for NCIs are following:

Six Member States[915], which currently allow non-credit institutions to operate on their territory without any requirements, will need to set up rules and procedures for the authorisation and registration of NCIs.

For NCIs, as only principles-based rules will be in place, NCIs willing to operate cross-border will need to comply with national requirements and therefore will be subject to some compliance costs. In the event that it is decided to open markets which are currently restricted to credit institutions, market access will be improved for NCIs. In these Member States[916] the

[911] See footnote 879.
[912] See footnote 66.
[913] See footnote 66.
[914] See footnote 879.
[915] See footnote 353.
[916] See footnote 879.

Commission services expect a market take-up which will gradually increase over time towards 3–5 %[917] or the 'average' market share for NCIs within the other Member States of the EU.

For consumers, this option is expected to improve consumer protection in Member States having currently no requirements for registration or authorisation in place. In these countries, consumer confidence in NCIs is expected to increase as consumers will be aware that all entities operating on the market are properly authorised and registered. In countries where NCIs are currently not allowed to operate, market entry of NCIs is expected to bring wider consumer choice but also an enhanced risk of consumer detriment.

<u>Quantification of costs and benefits</u>

Commission services consider that the introduction of principles-based rules for authorisation and registration of NCIs will result in benefits for consumers in the form of a decrease of defaults of the loans provided by NCIs representing between EUR 1.6–3.2 million of a reduction in defaulted loans. This amount is based on the following assumptions.

– This estimate is based on the gross value of mortgage loans at EUR 1 244 966 million in 2008, with an estimated overall market share of NCIs of 5.93 %[918] they represent EUR 73 853 million per annum. The total value of default mortgage credit by non-credit institution lenders is estimated at EUR 1 056 million based on the assumption that the default rate of 1.43 % for all mortgage loans is applicable to defaulted mortgage loans by NCIs. However, lack of available data prevents verification of this assumption.

– The Commission services estimated that if principles-based prudential rules could reduce the default rate by 0.5 to 1 basis points[919], the benefit for consumers could be a decrease in the range of EUR 1.6–3.2 million of the defaulted loans.

– This amount should be discounted for the fact that only in six Member States are there currently no rules in place. Therefore, the reduction in default levels is reduced by 78 %.

– Analysis of behaviour of NCIs, as reported in the UK Mortgage Market review[920], shows that NCIs in particular within the United Kingdom have been involved in 'high-risk lending' and therefore default rates for loans by NCIs are likely to be higher. As a result potential benefits could be higher than projected within this analysis.

– In addition to benefits to consumers, in the event of a decision to open the market to NCIs, some benefits could be expected by improved market access by opening up the market to NCIs in six Member States[921] which currently request all mortgage lenders to be registered as a credit institution. As this can be considered as a 'sub-option', and

917 See footnote 66. Average market share is estimated at 5.9 %.

918 See footnote 66. Actual market shares in 2007 within Member States were above 5 % in five Member States and vary from 0–1 % in nine Member States.

919 A base point is referred to as 0.01 %, so 100 base points equals 1 %.

920 See footnote 246, points 3.43–3.49.

921 See footnote 879.

there exist limited data to validate the assumptions, no quantification is performed for the purpose of this impact assessment. However, it can be expected that opening the market to NCIs, will lead to market entry of new players, which over time are expected to reach the average market share of NCIs within the EU today (5.9 %).

Commission services estimate that the incremental costs for NCIs in order to comply with a new authorisation and registration regime include a one-off cost of EUR 0.7 million and a recurring cost of EUR 0.7 million. These amounts can be broken down as follows.

– To set up the authorisation and registration process, NCIs are assumed to need to pay a registration fee of approximately EUR 2 500 each[922].This fee is based on the fee applied by the United Kingdom[923]. This represents a total cost of EUR 3.2 million for all market participants.

– In addition recurring costs are linked to the annual fee to be paid by NCI to cover regulatory reporting and customer contact centre, which amounts to EUR 1 500 or EUR 1.9 million for all NCIs.

– Recurring cost include equally annual compliance costs which are expected lead to 8 man hours of work per year, which would lead an annual cost of EUR 252 per NCI or EUR 0.3 million for all NCIs.

– As six Member States who allow for NCI, have no rules in place, the setup and recurring costs are reduced by 78 % to a one-off and recurring cost of EUR 1.5 million and EUR 1.1 million respectively.

It is assumed that Member States will incur one one-off costs of EUR 0.2 million for establishing an authorisation system and a register and a recurring cost of EUR 0.1 million. This can be broken down as follows.

– Implementing new rules would lead to one-off costs of EUR 23 529 per Member State. This would lead to a total cost of EUR 0.6 million for all Member States.

– In addition, Member States are expected to set up a database to follow up the registration process. Cost of design of a database is estimated at 30 man days. Under this assumption, cost to set up databases in those Member States without any requirements could amount to EUR 7 574 per Member State or EUR 0.2 million for all Member States.

– To ensure that enterprises are inserted into the national registers, it is assume this would take 4 man hours per NCI, leading to a total cost of EUR 8 109 for all NCIs.

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922 This is based on the registration fee that the United Kingdom charges for NCI. See footnote 544 for more information.

923 Depending on whether the application is straightforward, moderately complex or complex the on-off non-refundable fee for processing the application is respectively GBP 1 500, GBP 5 000 or GBP 25 000. For non-credit institutions, the application process is considered straight forward up to moderately complex. More information on http://www.fsa.gov.uk/pages/Doing/How/help/faqs/index.shtml.

- With regard to recurring costs, it is assume that yearly recurring authorisation of NCIs will consumer 4 man hours per NCI, leading to a total cost of EUR 0.2 million for all NCIs.
- In addition, it is assumed that yearly a total of 5 % of new entrants would lead to new authorisations, which would consume 24 man hours per new NCI or a total cost of EUR 0.1 million for all NCIs.
- As only six Member States allowing for NCI have no rules in place, the total incremental set-up and recurring costs are reduced by 78 %.

It should be noted that in the event that the six Member States[924] which currently require mortgage lenders to be licensed as credit institutions, would open up their markets for NCIs, both benefits and costs (setup and recurring for NCIs and Member States) would be doubled. Also under this latter assumption, the benefits of principles-based rules for authorisation and registration of NCIs would outweigh costs.

6.7.1.3. Option 1.3: Specific requirements

Effectiveness of policy option

The introduction of specific rules as outlined above will also address the problem of regulatory gaps to the authorisation and registration of NCIs at EU level.

This option would contribute to the objective of improving consumer confidence and minimising consumer detriment by ensuring that all NCIs have an effective internal process for assessing compliance with all internal policies and procedures, with a particular focus on qualifications, experience, staffing levels, and supporting automation systems. This compliance process is expected to improve NCIs staff expertise and competence and available support tools with regard to the financial products they offered to NCIs clients. As a result this process is will contribute to reduce risks of consumer detriment and will improve a wider protection for consumers. The public register, making public all authorised NCIs will ensure that consumers can check if they deal with properly authorised NCIs having the right competences to offer mortgages. This is expected to further improve the consumer confidence and minimising consumer detriment. In addition, as the rules will be the same in all Member States, there will be a level playing field for consumer protection within the EU.

Introducing specific rules will be efficient in order to ensuring that all NCIs comply with the same effective internal process for compliance with internal policies and procedures, contributing to the objective of a level playing field between all market players and facilitating cross-border activities. NCIs aiming at offering their services cross-border, will be subject to the same specific rules throughout the EU, improving legal certainty and facilitating the objective of promoting cross-border mobility by increasing clarity of the rules in place and reducing compliance costs. Specific rules will imply that all NCIs will comply with similar requirements ensuring a level playing field among NCIs within the EU. Furthermore, it reduces the likelihood for regulatory arbitrage.

924 See footnote 879.

Impacts of policy option on stakeholders and efficiency

The introduction of specific rules for the authorisation and registration of NCIs is expected to create a harmonised level of consumer protection. The introduction of specific requirements for an effective internal process for assessing compliance with internal policies and procedures will guarantee a high level of professionalism and competence and is expected to contribute to more responsible lending practices and therefore is expected to limit defaults levels.

Specific rules for the authorisation and registration of NCIs will lead to substantial compliance costs. In order to be authorised, NCIs will be subject to costs in order to fulfil the EU-wide requirements for effective internal process for assessing compliance with internal policies and procedures, in those Member States that currently do not have or have different rules in place. NCIs in Member States that have rules currently in place may also face some costs for adapting to the new specific rules to the extent that they differ from their current rules. However, as the requirements will be specific in all Member States, those NCIs willing to go cross-border will have less compliance costs.

For Member States the introduction of specific rules implies that all Member States will need to adapt to the EU-wide requirements for authorisation and registration of NCIs.

Quantification of costs and benefits

The benefits for consumers are estimated on the assumption that EU-wide rules could contribute to legal certainty, increase consumer confidence in NCIs and ensure that NCIs lend more responsibly, leading to a decrease in default rates. Commission Services expect that benefits for consumers of specific rules will amount to between EUR 11.1–18.4 million.

– This estimate is based on the gross value of mortgage loans in EUR 1 244 966 million in 2008, with an estimated overall market share of NCIs of 5.93 %[925] they represent EUR 73 853 million per annum. The total value of default mortgage credit by non-credit institution lenders is estimated at EUR 1 056 million based on the assumption that the default rate of 1.43 % for all mortgage loans is applicable to defaulted mortgage loans by NCIs. However, lack of available data prevents verification of this assumption.

– The Commission services estimated that if principles-based prudential rules could reduce the default rate by 1.5 to 2.5 basis points[926], the benefit for consumers could be a decrease in the range of EUR 11.1–18.4 million of the defaulted loans.

– In addition, benefits for NCIs due to increased business opportunities by opening up the market in some Member States and facilitation to operate cross-border due to improved legal certainty and reduction of compliance costs, due to the same specific rules in all Member States, could be expected. However, for the purpose of this impact assessment they have not been quantified.

The Commission services consider that NCIs could be subject to one-off costs and recurring costs in order to comply with the requirements and standards for authorisation and registration

[925] See footnote 918.
[926] A base point is referred to as 0.01 %, so 100 base points equals 1 %.

which could amount up to EUR 3.2 million for setting up the authorisation system and EUR 2.3 million annual recurring costs for renewal of the authorisation, for all NCIs within the EU. This is broken down as follows.

– To set up the authorisation and registration process, NCIs are assumed to need to pay a registration fee of approximately EUR 2 500 each[927].This fee is based on the fee applied by the United Kingdom[928]. This represents a total cost of EUR 3.2 million for all market participants.

– In addition recurring costs are linked to the annual fee to be paid by NCI to cover regulatory reporting and customer contact centre, which amounts to EUR 1 500 or EUR 1.9 million for all NCIs.

– Recurring cost include equally annual compliance costs which are expected lead to 8 man hours of work per year, which would lead an annual cost of EUR 252 per NCI or EUR 0.3 million for all NCIs.

– As all Member States will need to adapt to the new specific rules, there is no discount applied.

For Member States, the introduction of specific rules is expected to generate to setup costs of EUR 0.8 million for establishing the authorisation system and a register and a recurring costs of EUR 0.2 million. This can be broken down as follows.

– Implementing new rules is expected to generate to one-off costs of EUR 23 529 per Member State. This would imply a total cost of EUR 0.6 million for all Member States.

– In addition, Member States will be required to set up a database to follow up the registration process. Cost of design of a database is estimated at 30 man days. Under this assumption, cost to set up databases in those Member States without any requirements could amount to EUR 7 574 per Member State or EUR 0.2 million for all Member States.

– To ensure that enterprises are inserted into the national registers, it is assumed that this would take 4 man hours per NCI, leading to a total cost of EUR 8 109 for all NCIs.

– With regard to recurring costs, it is assume that yearly recurring authorisation of NCIs will consumer 4 man hours per NCI, leading to a total cost of EUR 0.2 million for all NCIs.

– In addition, it is assumed that yearly a total of 5 % of new entrants would lead to new authorisations, which would consume 24 man hours per new NCI or a total cost of EUR 0.1 million for all NCIs.

927 See footnote 922.
928 See footnote 923.

6.7.1.4. Option 1.4: Introduction of a passport

Effectiveness of policy option

Under this option, NCIs duly authorised and supervised in the home Member State, will be able to provide services in the host Member State under the supervision of the home Member State without further authorisation. This option would contribute to the objective of tackling barriers to cross-border mobility for NCIs by removing the obligation to seek authorisation and register in each of the 27 Member States when aiming to offer their services cross-border. As in the large majority of Member States, NCIs only represent a limited market share, there is no evidence available supporting the notion that the introduction of a passport for NCIs would lead to large cross-border activity and thus increase.

Establishing a passport would contribute to the objective of creating a level playing field for all lenders operating in the internal market, as all registered and authorised and supervised lenders would be enabled to receive a passport. The introduction of a passport is expected to lead to new business opportunities for NCIs, theoretically creating more choice for consumers and lower prices due to more market participants. However, while this opportunity remains theoretically possible, there is no evidence suggesting that this cross-border activity will materialise.

Finally, as only NCIs which are properly authorised registered and licensed would receive an EU passport, the impact effect of this option would be neutral with regard to minimising the risk of consumer detriment.

Impacts of policy option on stakeholders and efficiency

Consumers are expected to receive positive impacts as the 'free movement of NCIs' will lead to more market players and therefore provide a greater choice and lower prices due to more competition. In addition, a more responsible cross-border provision of mortgage credit by NCIs can be expected, as they will authorised before passporting their services. This is expected to lead to defaults especially in those Member States with no rules in place. However, there is also a theoretical risk of more consumer detriment due to the availability of 'riskier' products that are traditionally offered by NCIs, in those markets who currently do not allow for NCis. There is however currently no available evidence that this measure would lead to a considerable increase in cross-border activity by NCIs.

NCIs will be positively impacted as there will in principle not be an extra regulatory barrier to go cross-border which will create business opportunities for NCIs willing to go cross-border. As the application of a passport will be linked to the regular authorisation and registration process for NCIs, this is expected not to generate incremental costs in comparison with the introduction of specific rules for NCIs.

For Member States are impacted as the home Member State would have to extend its supervisory activity to NCIs which operate cross-border. However, these additional costs are expected to be negligible.

Quantification of costs and benefits

Some benefits for consumers are expected due to responsible provision mortgage credit offered by NCI operating cross-border, leading to less defaults levels. This is especially the case in those Member States which currently allow for NCIs to operate on their territory without any rules in place, which is estimated at EUR 0.8 million. These benefits are estimated as following.

– This estimate is based on the gross value of mortgage loans in EUR 1 244 966 million in 2008, with an estimated overall market share of NCIs of 5.93 %[929] they represent EUR 73 853 million per annum. The total value of default mortgage credit by non-credit institution lenders is estimated at EUR 1 056 million based on the assumption that the default rate of 1.43 % for all mortgage loans is applicable to defaulted mortgage loans by NCIs. However, lack of available data prevents verification of this assumption.

– The Commission services estimated that if principles-based prudential rules could reduce the default rate by 0 to 0.5 basis points[930], the benefit for consumers could be a decrease in the range of EUR 0–3.6 million of the defaulted loans.

– This amount should be discounted for the fact that only in six Member States, there are currently no rules in place. Therefore, the reduction in default levels is reduced with 78 %.

Additional benefits are expected from improved choice and lower prices. Some costs will also be faced due to the increased possibility of consumer detriment. However, based on the data available, no reasonable quantification can be performed.

As the attribution of a passport is linked to specific rules on authorisation and registration for NCIs, the introduction of a passport is expected not to lead to incremental costs due to the limited number of NCIs. It is expected to lead to an increased cost for Member States for authorisation of NCIs willing to go cross-border.

6.7.2. Options on prudential requirements and supervision for NCIs

6.7.2.1. Option 2.1: Do nothing

<u>Effectiveness of policy option</u>

Not introducing prudential requirements and supervision of NCIs will not address the regulatory gaps in this field.

Certain Member States[931] will continue impose prudential requirements and supervise NCIs, while others will not. This option does not therefore contribute to the objective of minimising consumer detriment as consumer protection levels will continue to vary among Member States along with the levels of supervision. It should be noted that, the EU market, in which at present six Member States[932] require all lending institutions to be credit institutions, while in other Member States no such requirement exist, will remain fragmented.

In addition, as prudential requirements and corresponding supervision vary, NCIs will have to comply with levels of different prudential requirements (from no requirements up to

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929 See footnote 918.
930 A base point is referred to as 0.01 %, so 100 base points equals 1 %.
931 See footnote 852.
932 See footnote 879.

requirements equal to credit institutions) when operating in a cross-border environment, hereby creating substantial additional costs. Therefore, this option does not contribute to the uptake of cross-border activity and lead to an absence of level playing between market participants both at a domestic and cross-border level.

Finally, as shown in the problem section on lack of supervision (Section 7.3.2) without appropriate supervision in place, NCIs can quickly enter the market, achieving a rapidly growing market share, and afterwards disappear from the market with the corresponding risks for financial stability.

Impacts of policy option on stakeholders and efficiency

For consumers, the consumer protection level will continue to vary with differing prudential requirements and different supervisory approaches. In some Member States[933] this means that NCIs will not be present due to the need to comply with the prudential requirements and supervision of credit institutions, while in others absence of prudential requirements and supervision may lead to consumer detriment, in the form of foreclosures, repossessions and overindebtedness in the absence of checks on the fitness and probity of NCIs in the market.

For NCIs, compliance costs due to different levels of prudential requirements and supervision will remain and will continue to vary. For example, in six Member States to offer mortgage credit a NCI would need to apply for a banking license, requiring an initial capital of EUR 5 million, to offer its services, even if it would not take deposits, while in other Member States, no such prudential requirement applies.

6.7.2.2. Option 2.2: Principles-based requirements

Effectiveness of policy option

This option is expected to address the regulatory gaps for prudential requirements and supervision of NCIs by requiring Member States to determine prudential requirements and setting up a process for supervising NCIs.

Under this option, in Member States[934] in which non-banks operate but are not yet subject to prudential requirements, consumer protection is expected to increase as Member States would need to define prudential requirements and a supervisory process for NCIs. In the event that Member States[935] who currently only allow credit institutions to offer mortgage credit, would choose to authorise NCIs, it can be expected that they would equally establish proportionate prudential requirement and supervision for NCIs. However, as Member States will be free to choose which prudential requirements they apply, for instance, adherence to a compensation scheme, initial (and ongoing) capital, or the introduction of an ombudsman service, the actual levels of consumer protection will remain unequal throughout the 27 Member States. In addition, as it remains to national competent authorities to determine the scope of the supervision, consumer protection will vary among Member States.

At the same time, the introduction of principles-based rules will improve the creation of a level playing field between all actors as prudential requirements and supervision are likely to

933 See footnote 879.
934 See footnote 353.
935 See footnote 879.

be based on corresponding principles. However, this objective will not be achieved. While Commission services expect some improvements in comparison with the status quo, as all Member States will need to impose prudential requirements this scenario, actual levels of prudential requirements will vary, creating an unlevel playing field between actors operating in different Member States.

Finally, principles-based prudential requirements will improve the ability of NCIs to go cross-border as in some Member States who do not allow for NCIs, they will be allowed into the market, subject to prudential requirements. However, this objective will not be fully achieved as different national of requirements will create costs for NCIs willing to operate cross-border. These costs will include compliance costs to implement the national requirements in addition to the need of legal advice to comply.

<u>Impacts of policy option on stakeholders and efficiency</u>

With respect to consumers, Commission services expect that principles-based rules on prudential requirements and supervision will lead to more prudent operations by NCIs, leading to responsible lending and fewer defaults. However, this option could have negative effects as the costs for NCIs of adhering to these principles may affect the price consumers have to pay for credit.

There will be economic impacts for NCIs as Member States will have a requirement to impose national prudential requirements and supervision on NCIs. The economic impact on NCIs depends on the existing (or non-existing) prudential and supervisory framework in place. Therefore some NCIs could face a requirement to have, e.g. a certain amount of initial capital, leading to additional costs. Although a more convergent approach to prudential requirements could facilitate cross-border activity by NCIs, the compliance costs for NCIs will remain higher then for specific requirements, as they will still need to comply with different national requirements.

The costs for Member States for introducing principles-based rules for prudential requirements and supervision are mainly related to the allocation of resources to conduct the supervisory activity, especially for those Member States with currently no supervision in place.

<u>Quantification of costs and benefits</u>

Commission Services consider that thee introduction of prudential requirements will result in benefits for consumers in the form of a decrease of defaults of the loans provided by NCIs. These are estimated at EUR 1.3–6.6 million. This can be broken down as follows.

– The Commission services estimated that if principles-based prudential rules could reduce the default rate by 0.5 to 1 basis points, the benefit for consumers could be a decrease in the range of EUR 6.2–29.5 million of the defaulted loans. Analysis of behaviour of NCIs, as reported in the UK Mortgage Market review[936], shows that NCIs within the United Kingdom have particularly been involved in 'high-risk lending' and therefore default rates for loans by NCIs are likely to be higher. As a result potential benefits could be higher then projected within this analysis.

[936] See footnote 246, points 3.43–3.49.

– However reductions in defaults are reduced with 78 % as only six Member States[937] currently have no rules in place, and 14 Member States have some rules in place.

Estimated costs for NCIs linked to the introduction of prudential requirements and supervision are estimated at between EUR 1.3–3.5 million. These are estimated based on following.

– The costs of a adherence to a compensation scheme is based on the assumption that a risk premium of 0.004 % of the outstanding amount would be requested for the compensation scheme, this represent a total of EUR 2.9 million for all NCIs or EUR 2 229 per NCI.

– NCIs are assumed to incur certain costs in order to enable the competent national authorities to perform the oversight controls. NCIs are expected to comply with annual reporting requirements by supervisors which could take 4 hours to prepare by one person for EUR 31.56 costs per hour which amounts to EUR 0.2 million of total costs for all NCIs.

– Costs for NCIs are reduced with 78 % as only six Member States allowing NCIs do to operate do have any rules in place.

For Member States the introduction of prudential requirements and to perform oversight controls could lead to a one-off cost of EUR 0.2 million to implement new rules and a recurring cost of EUR 0.1 million to ensure annual oversight. This can be broken down as follows.

– The Commission services estimate that there will be a set-up of EUR 23 529 per Member State to implement new rules, which equals EUR 0.6 million for all Member States.

– The recurring cost for Member States includes checking of reporting data by the supervisor, which is expected to require 4 man hours at a rate of EUR 31.56 per hour which will amount to EUR 0.2 million for all NCIs.

– Furthermore, the Commission services consider that Member States will need to set perform on-site inspections which would equally require 4 man hours per NCI which would be performed for half of the NCIs, leading to a cost of EUR 0.1 million for all NCIs.

Costs are discounted at 78 % as only 6 Member States currently have no rules in place.

6.7.2.3. Option 2.3: Specific requirements

<u>Effectiveness of policy option</u>

Under this option, harmonised and proportionate prudential requirements and supervision would be established for NCIs which would equally address the regulatory gaps in these areas.

[937] See footnote 353.

Harmonised prudential requirements and supervision would contribute to achieving the objective of reducing consumer detriment and increase protection of consumers as all NCIs within the EU would need to comply with the same rules. In addition, specific rules would promote the creation of a level playing field as all NCIs within the EU would be subject to the same specific rules for supervisory purposes.

This option would also be effectively contribute to the objective of promoting cross-border mobility by NCIs. NCIs will have legal certainty and clarity on the supervisory rules in place when going cross-border, hereby limiting compliance costs for NCIs willing to operate in multiple Member States.

<u>Impacts of policy option on stakeholders and efficiency</u>

The most important benefit for consumers is that rogue NCIs will have more difficulties to enter the market and act irresponsibly due to the introduction of prudential requirements and more oversight on the market participants, which could increase prudent lending and a reduced risk of defaults. However, the prudential requirements will impose some costs on NCIs, which they could pass on to consumers.

The introduction of specific rules regarding prudential requirements will have an impact on NCIs, which will depend on the existing prudential requirements and supervisory framework in place. There will be costs for NCIs of complying with the new requirements; such as initial capital, particularly in those Member States[938] which currently do not have such requirements in place. Depending on the actual level of prudential requirements chosen this might be an entry barrier if the chosen level is too high in relation to the business volume. However, in those Member States[939], which currently request an authorisation as a credit institution to enter the market, new prudential requirements are expected to improve market access for NCIs as specific rules are expected to be proportionate to their activity.

For Member States, the impacts on costs will depend on the existing framework in place. In Member States[940] without rules in place, the introduction of prudential requirements and the creation of a supervisory framework will create costs for public authorities to set up this process and ensure the supervisory tasks are attributed, including a check of the prudential requirements and code of business conduct rules.

<u>Quantification of costs and benefits</u>

Commission services consider that the introduction of specific prudential requirements will result in benefits for consumers in the form of a decrease of defaults of the loans provided by NCIs. Total reduction in defaults is estimated at EUR 3.2 million up to EUR 17.2 million.

– This estimate is based on the gross value of mortgage loans in EUR 1 244 966 million in 2008, with an estimated overall market share of NCIs of 5.93 %[941] they represent EUR 73 853 million per annum. The total value of default mortgage credit by non-credit institution lenders is estimated at EUR 1 056 million based on the assumption that the default rate of 1.43 % for all mortgage loans is

[938] See footnote 353.
[939] See footnote 879.
[940] See footnote 353.
[941] See footnote 918.

applicable to defaulted mortgage loans by NCIs. However, lack of available data prevents verification of this assumption.

– The Commission services estimate that if principles-based prudential rules could reduce the default rate by 0.5 to 1.5 basis points, the benefit for consumers could be a decrease in the range of EUR 6.2–29.5 million of the defaulted loans.

– The benefits are discounted with 48 % as today already 14 Member States have currently some rules in place. As a result, the full default reductions for those Member States cannot be taken into account.

– Analysis of behaviour of NCIs, as reported in the UK Mortgage Market review[942], shows that NCIs within the United Kingdom have particularly been involved in 'high-risk lending' and therefore default rates for loans by NCIs are likely to be higher. As a result potential benefits could be higher then projected within this analysis.

Estimated recurring costs linked to the introduction of specific rules for prudential requirements for NCIs are estimated at between EUR 3.1–4.1 million. This can be broken down as following.

– The recurring costs of a adherence to a compensation scheme is based on the assumption that a risk premium of 0.004 % of the outstanding amount would be requested for the compensation scheme, this represent a total of EUR 2.9 million for all NCIs or EUR 2 229 per NCI.

– NCIs are assumed to incur certain costs in order to enable the competent national authorities to perform the oversight controls. NCIs are expected to comply with annual reporting requirements by supervisors which could take 4 hours to prepare by one person for EUR 31.56 costs per hour which amounts to EUR 0.2 million of total costs for all NCIs.

– In addition, specific rules could introduce requirements to assist on-site inspections, which could take 4 man hours per NCI, leading to a cost of EUR 0.2 million for all non-credit institution lenders.

– As rules are specific, changes for Member States with currently some rules in places will depend on the discrepancy between the current rules in place and the new specific rules. For the purpose of this option, abstraction is made from any discount and the full recurring cost is applied as it is expected that the majority of NCIs would need to adapt to the new specific rules.

For Member States the introduction of specific rules on prudential requirements and supervision of NCIs could lead to a one-off cost of EUR 0.6 million to implement new rules and a recurring cost of EUR 0.2 million to ensure annual oversight. This can be broken down as follows.

[942] See footnote 246, points 3.43–3.49.

– The Commission services estimate that there will be a set-up of EUR 23 529 per Member State to implement new rules, which equals EUR 0.6 million for all Member States.

– The recurring cost for Member States includes checking of reporting data by the supervisor, which is expected to require 4 man hours at a rate of EUR 31.56 per hour which will amount to EUR 0.2 million for all NCIs.

– Furthermore, the Commission services consider that Member States will need to set perform on-site inspections which would equally require 4 man hours per NCI which would be performed for half of the NCIs, leading to a cost of EUR 0.08 million for all NCIs.

– As rules are specific, changes for Member States with currently some rules in places will depend on the discrepancy between the current rules in place and the new specific rules. For the purpose of this option, abstraction is made from any discount and the full recurring cost is applied as it is expected that the majority of Member States would need to adapt their regulations to comply with the new specific rules.

6.7.2.4. Option 2.4: Introduction of EU level supervision

Effectiveness of policy option

Under this option, the coordination of micro-prudential supervision by Member States will be attributed to an EU body, hereby addressing the regulatory gaps in the field of supervision and contributing to the creation of a real European market for NCIs.

This option would contribute to achieving the objective of improving consumer protection as due to improved exchange of information of developments of micro-prudential supervision at national level, faster responses could be developed when problems arise in national markets. Therefore, this option would contribute positively to minimising consumer detriment.

In addition, as this approach is expected to ensure better information exchange between national operators, an EU body could contribute to improve harmonised supervisory actions by national competent authorities, and therefore, would be an effective measure to promote the creation of a level playing field.

In addition, as this body is expected to improve coordination of supervisory activities, it is expected that EU level supervision will facilitate cross-border activity.

Impacts of policy option on stakeholders and efficiency

The impact of this option is mostly applicable to the Member States competent authorities that will incur costs in cooperating and communicating with the EU level authority. The Member States' supervisory authorities will need to establish an administration that reports, and have other institutional arrangements to allow for the EU authority to function. The benefits of the EU supervision is that national problems will be discussed at EU level and therefore faster action and a more harmonised response can be taken if problems occur in one Member State, avoiding the spreading of risks within the EU.

NCIs will only be impacted to the extent that there will be another higher authority which can impose certain requirements.

The benefits for consumers of an EU level supervision of NCIs will be that legal certainty, the guarantee for financial stability is improved.

Quantification of costs and benefits

It is expected that a better exchange of information is expected to have a positive impact on the default levels. Reductions in defaults are estimated in the range of EUR 0–6.2 million.

– This estimate is based on the gross value of mortgage loans in EUR 1 244 966 million in 2008, with an estimated overall market share of NCIs of 5.93 %[943] they represent EUR 73 853 million per annum. The total value of default mortgage credit by non-credit institution lenders is estimated at EUR 1 056 million based on the assumption that the default rate of 1.43 % for all mortgage loans is applicable to defaulted mortgage loans by NCIs. However, lack of available data prevents verification of this assumption.

– The Commission services estimated that EU supervision will reduce risk of spreading of problems arising in individual Member States and this could reduce the default rate up to 0.5 basis points, the benefit for consumers could be a decrease up to of EUR 6.2 million of the defaulted loans.

The costs for Member States public authorities of EU level supervision are based on four meetings organised per year, representing EUR 0.1 million. This option would not generate any costs for NCIs.

6.7.3. Comparison of options

6.7.3.1. Comparison of options on authorisation and registration of NCIs

The analysis of the options above demonstrates that the objectives of this initiative cannot be achieved under the 'Do nothing' scenario. It has been shown that this option is not effective as it preserves the status quo and thus all the problems that have been identified in the problem section.

943 See footnote 918.

Table 50: Authorisation and registration of NCIs – Comparison of options

	Effectiveness in achieving the objectives below							Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives						
	Ensure appropriate regime for uptake, pursuit and supervision of NCIs	Efficient and competitive Single Market with a high level of consumer protection				Financial stability		
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field			
1.1: Do nothing	0	0	0	0	0	0		0
1.2: Principles-based requirements	✓✓	✓✓	✓	0	✓	✓✓		✓✓
1.3: Specific requirements	✓	✓✓✓	✓	✓✓	✓✓	✓✓		✓
1.4: Introduction of a passport	✓	0	0	✓✓✓	✓✓	0		✓

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Option 1.2 was found to contribute to ensuring an appropriate regime for the registration and authorisation of NCIs. More particularly, this option is considered effective in meeting the objective of improving consumer protection and consumer mobility and is more effective than the 'Do nothing' option with regard to achieving the objectives of ensuring a level playing field and ensuring a harmonised and proportionate registration and authorisation.

However it will be less effective, in comparison to Option 1.3 in tackling barriers to cross-border mobility and ensuring a level playing field between NCIs as national rules will continue to differ somewhat. Option 1.3 is considered more effective in achieving the objective of minimising consumer detriment and promoting cross-border activity in comparison with Option 2. However, Option 1.3 is considered less efficient in achieving these objectives in comparison with Option 1.2 which can achieve the same objectives with fewer costs.

Finally, Option 1.4, is considered to be the most effective in promoting cross-border activity and equally effective in ensuring a level playing field between all players.

Table 51: Authorisation and registration of NCIs – Impact on main stakeholders

Stakeholders/ Policy options on authorisation and registration	Consumers	NCIs	Member States
1.1: Do nothing	0	0	0
1.2: Principles-based requirements	✓✓	×/0	×/0
1.3: Specific requirements	✓✓/✓✓✓	××/×	×0
1.4: Introduction of a passport	✓	✓	×/0

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive impact
××× (Strong) – ×× (Moderate) – × (Weak) negative impact – 0 neutral impact

In terms of benefits and costs, the 'Do nothing' scenario does not entail any financial costs or benefits.

Option 1.2 and Option 1.3 are expected to bring benefits to consumers as the introduction of authorisation registration requirements are expected to increase consumer protection and reduce default levels by consumers. Option 1.3, specific requirements, has the potential to bring more benefits than Option 1.2, as under the latter, consumer protection levels will continue to vary among Member States depending on national implementations. Option 1.4 is expected to bring benefits for consumers in terms of increased consumer choice, more competition due to new NCIs entering the market. This could eventually result in better prices for consumers.

In terms of costs for NCIs, Option 1.2 is expected to generate lower costs than Option 1.3 for executing the process of authorisation as in Option 1.3 all NCIs are expected to change the processes to comply with new EU-wide specific rules, while under Option 1.2 authorisation and registration requirements will change only in some Member States. However, due to the limited cross-border activity of NCIs, differences in cost between both options are limited and do not outweigh the expected benefits of reduced default levels. In addition, the additional benefits of Option 1.4 are limited, both for consumers and NCIs due to the limited market share and limited cross-border activity of NCIs. Option 1.4 is expected to facilitate cross-border provision of mortgage credit by NCIs, and therefore create new business opportunities for NCIs.

Regarding Member States, the costs for public authorities to implement Option 1.2 are lower then for Option 1.3. Option 1.3 would have a higher set up and recurring cost as all Member States would need to apply new rules. The costs of passporting are considered as part of Option 1.3 and would not lead to any incremental costs. The introduction of a passport (Option 1.4) is not expected to generate incremental costs for Member States, as these should be covered by the introduction of the authorisation system in place. As such for Member States economies, the increased market stability is expected to be a positive effect from all options except for the status quo.

Table 52: Authorisation and registration of NCIs – Costs and benefits of the policy options

Total EU benefits (million EUR)	**Option 1.1**	**Option 1.2**	**Option 1.3**	**Option 1.4**
Consumer/social benefits:				
reduction in defaults	0	1.6–3.2	11.0.–18.4	–
Provider benefits:				
new business opportunities	0	not quantified	not quantified	not quantified
Total EU costs (million EUR)	**Option 1.1**	**Option 1.2**	**Option 1.3**	**Option 1.4**
Provider costs:				
one-off	0	0.7	3.2	–
recurring	0	0.7	2.2	
Member State costs:				
one-off	0	0.3	1.0	–
recurring	0	0.1	0.2	

To conclude, in view of the overall market share and cross-border activity of NCIs, the most appropriate and proportionate option appears to be Option 1.2, the introduction of principles-based rules for the authorisation and registration of NCIs, this in view of different market situations of Member States. In some Member States, such as the United Kingdom, the Netherlands and Belgium, the market share of NCIs can be considered material, while in other Member States, NCIs' market share is small or NCIs are not present on the market.

6.7.3.2. Comparison of options on prudential requirements and supervision

Maintaining the existing situation of the 'Do nothing' scenario will entail status quo and therefore is not expected to contribute to any of the policy objectives.

Table 53: Prudential requirements and supervision of NCIs – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency (cost-effectiveness) in achieving all listed objectives
	Specific objectives	General objectives					
	Ensure appropriate regime for uptake, pursuit and supervision of NCIs	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Principles-based requirements	✓✓	✓✓	✓	0	✓	✓✓	✓✓
2.3: Specific requirements	✓	✓✓✓	✓	✓	✓✓	✓✓	✓
2.4: Introduction of EU level supervision	✓	0	0	✓✓✓	✓✓	0	✓

Contribution to objectives compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive contribution
××× (Strong) – ×× (Moderate) – × (Weak) negative contribution – 0 neutral contribution

Introducing principles-based rules (Option 2.2) is expected to contribute to the objective of improving consumer protection in Member States with no rules in place; NCIs' prudential requirements will be introduced and Member States will start set up a supervisory framework. However, Option 2.2 will not contribute to achieving the objective of on tackling cross-border mobility. In addition, the contribution to the creation of a level playing field between all market players will be limited to the 'national level' as EU rules will continue to differ. The main improvement, if it is decided to incorporate market access under Option 2.2, will be that Member States which currently do not allow for NCIs to enter the market will open up their markets for NCIs.

The introduction of specific rules (Option 2.3) is expected to have a greater impact on the objective of consumer protection then principles-based rules, as the level of consumer protection will be subject to the same specific rules within all Member States. In addition, this option will have a more positive impact to cross-border mobility of NCIs and will better create a level playing field between all providers as it would generate more legal certainty as same specific rules would need to be applied in all Member States. However, Option 2.3 is less cost-efficient in comparison with principles-based rules (Option 2.2) as it would request all Member States to adapt their rules and supervisory framework to the EU rules, whereas under Option 2.2, only some Member States would have to modify their frameworks.

Option 2.4 would in principle address the regulatory gaps in prudential requirements and supervision. However, in view of the currently limited level of cross-border activity of NCIs, the establishment of a supervisory authority appears as a disproportionate measure. The introduction of principles-based rules is not expected to be efficient in tackling cross-border activity in comparison with specific rules which could enhance legal certainty for NCIs willing to offer their services cross-border. Overall, in view of the limited market share and limited cross-border activity of NCIs, while the introduction of specific rules (Option 2.3) might be more efficient in creating a harmonised legal framework for the supervision of NCIs, the introduction of principles-based rules (Option 2.2) could be considered sufficient to achieve this objective.

Table 54: Prudential requirements and supervision of NCIs – Impact on main stakeholders

Stakeholders/ Policy options on prudential requirements and supervision	Consumers	NCIs	Member States
2.1: Do nothing	0	0	0
2.2: Principles-based requirements	✓✓	×	×/0
2.3: Specific requirements	✓✓✓	××/×	×/0
2.4: Introduction of EU level supervision	✓	0	×/0

Impact on stakeholders compared to the situation today,
✓✓✓ (Strong) – ✓✓ (Moderate) – ✓ (Weak) positive impact

Principles-based rules (Option 2.2) and specific rules (Option 2.3) are expected to have similar positive impacts on the reduction of default levels and therefore will have a positive impact on consumers. However, as prudential requirements and supervision will set the same level requirements in all Member States under the option of specific rules, Option 2.3 is expected to have the largest potential in terms of reduction of defaults.

For NCIs, Option 2.3 will generate more costs than Option 2.2 in terms of the adaption of processes to meet new requirements. In the case of specific rules (Option 2.3), all NCIs will need to adapt their process to comply with the new rules, while under Option 2.2 only in those Member States with currently no rules in place, there will be new rules which will generate some compliance costs. In terms of benefits, both principles-based rules (Option 2.2) and specific rules (Option 2.3) will reduce costs to enter the market which currently do not allow for NCIs, hereby creating new business opportunities.

For Member States, the main economic impact of the different options appears equal in terms of improving the market stability by an improved supervision, especially in markets where currently no such supervision is conducted. However, in those Member States, the introduction of supervision will create some operational costs for public authorities. These costs will be slightly higher for specific rules (Option 2.3) than for principles-based rules (Option 2.2), as under the latter, a smaller number of Member States will need to adapt their rules. However, in both cases, the costs for Member States will remain limited.

Table 55: Prudential requirements and supervision of NCIs – Costs and benefits of the policy options

Total EU benefits (million EUR)	Option 2.1	Option 2.2	Option 2.3	Option 2.4
Consumer/social benefits: reduction in defaults	0	1.3–6.5	3.2–17.5	0–6.2
Total EU costs (million EUR)	**Option 2.1**	**Option 2.2**	**Option 2.3**	**Option 2.4**
Provider costs: one-off recurring	0	– 0.7	– 3.1	–
Member State costs: one-off recurring	0	0.2 0.1	0.6 0.2	– 0.1

To conclude, in view of the overall market share and cross-border activity of NCIs, the most appropriate and proportionate option appears to be the introduction of principles-based rules (Option 2.2) for introducing prudential requirements.

6.8. Assessment of the policy instruments

6.8.1. Non-binding Community instrument

A Communication to stakeholders in the NCIs market is unlikely to have a stronger effect than proposing self-regulatory measures.

Similarly, a Commission Recommendation to Member States for the setting rules for the authorisation and registration of NCIs is very unlikely to have impact in due to its non-binding character. Similarly, the introduction of prudential requirements and supervision of them cannot be enforced by self-regulatory measures. Therefore, the opening up of the market for NCIs in Member States who currently do not allow them on the market is unlikely to happen.

6.8.2. Binding Community instrument

The introduction of binding community instrument is expected to be more efficient in addressing regulatory gaps for the authorisation, registration and prudential requirements and supervision of NCIs. Only a binding Community instrument can ensure that the recommended principles-based rules are put in place in Member States which currently do not have such an authorisation registration and supervision process or which do not allow for NCIs to enter the market.

In general, the Commission has the choice between a Directive and a Regulation as a binding policy instrument. A Directive has, on the one hand, the advantage of allowing for a more flexible approach, enabling both minimum and maximum harmonisation within the same instrument and thus is able to take into account the specificities of national markets. A minimum harmonisation Directive would allow more flexibility to Member States than a maximum harmonisation Directive, which would reduce the possibilities for Member States to gold plate. A Regulation, on the other hand, theoretically allows achieving the highest level of harmonisation and standardisation in a shorter timeframe without the need for national transposition measures. It also enables private enforcement by consumers and business alike, thus bringing the single market closer to the citizen.

Setting up a process for authorisation, registration and supervision does not appear to require full standardisation at technical level as national market characteristics should be taken into account due to the different levels of maturity and market share of NCIs within the EU. This argues in favour of a Directive rather than a Regulation. While a Directive approach with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national specificities of the market. It is therefore recommended to use the legal instrument of a Directive for the authorisation, registration and supervision of NCIs.

6.9. Impact on Community resources and impacts on third countries

The recommended option of creating principles-based requirements for the authorisation, registration and the introduction of prudential requirements and supervision of NCIs does not have any perceived impacts on European Community resources.

As already described above, the main social impacts relate to the reduction in defaults of mortgage loans issued by NCIs. In addition, an integrated mortgage market will help the entry of new NCIs which are currently not allowed to operate in some Member States and therefore could contribute to more consumer choice and financial inclusion of unbanked consumers. On the downside, introducing requirements for authorisation, registration and supervision of NCIs may lead to more responsible behaviour which might make it more difficult for some consumers when applying for mortgage loans. However, this does not outweigh the benefits of fewer defaults.

As regards the environment, no impacts are expected.

With regard to the impact on third countries, the introduction of authorisation registration and supervision of NCIs will not lead to discrimination as NCIs from third countries willing to offer their services on the EU territory would need to comply with the same rules. If the proposed Directive is extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway. Finally, no direct impact on other countries is expected.

6.10. Conclusions

The introduction of rules on authorisation and registration as well as on prudential requirements and supervision are expected to close the regulatory gaps in these areas and generate positive impacts on the market. On the one hand it is expected that these rules will open up the market for NCIs in some Member States which currently do not allow them in the market and on the other hand, it will increase consumer protection and reduce default levels in Member States without rules in place Therefore, the benefits will imply both increased consumers choice and reduction of default levels as a result of proportionate rules. Market forces and self regulatory efforts do not appear to be sufficient to promote a proportionate authorisation registration and supervisory process for NCIs. In this context, it is recommended to set principles-based rules for the authorisation and registration and prudential supervision of NCIs by means of a Directive.

ANNEX 5: Methodology for assessing the costs and benefits

1. ASSUMPTIONS

The following figures were used to calculate the costs and benefits of the different policy options.

– EU average hourly cost of employees in financial institutions, NCIs and credit intermediaries in 2007: EUR 31.56[944]. Unless otherwise stated, this hourly wage is used for all calculations for a working day of 8 hours. The cost for one man day is EUR 31.56 x 8 hours= EUR 252.48.

– Value of EU mortgages originated in 2007: EUR 1 244 966 million.[945]

– Average percentage of intermediated mortgage loans in EU27 in 2007: 41.5 %[946].

– Total number of EU mortgage transactions 2007: approximately 6 136 081. Extrapolation using data from *Hypostat 2008: A review of Europe's Mortgage and Housing Markets*.[947] For countries where 2007 data is not available, most recent available data was used as a proxy. Data for Bulgaria, Cyprus, Czech Republic, Lithuania, Malta, and Slovakia is not available, however, together these represent about 1.67 % of EU mortgage markets.

– Total number of EU credit institutions end-2009: 8 357. This figure is 82 % of the number of MFIs at end 2009 (10 192)[948].

– Overall market share of NCIs is estimated at 5.9 %, i.e. about EUR 52.8 billion per annum.[949]

– Total number of EU NCIs is estimated by Commission services at around 1 285[950]. This amount has been estimated by the Commission services based on the market share (5.9 %) of non-credit institutions in the mortgage credit market as reported in the *Study on the Role and Regulation of Non-credit Institutions in EU Mortgage Markets*[951]. As non-credit institutions are generally small entities in comparison with

944 *Hourly labour costs, Financial Intermediation – Nace Rev. 1.1*, Eurostat, 2008.

945 See footnote 1.

946 See footnote 6.

947 See footnote 1.

948 *Monetary Financial Institutions (MFI) statistics*, European Central Bank, 20.1.2010, http://www.ecb.int/press/pr/date/2010/html/pr100120.en.html.

949 Estimate based on actual market shares as reported in *Study on the role and regulation of non-credit institutions in EU mortgage markets*, London Economics, September 2008. It should be noted that the actual market share of not credit institutions varies widely among Member States from less than 1 % in some Member States up 12 % in the United Kingdom. In addition, six Member States do not allow non-credit institutions to operate on their territory. Therefore, the United Kingdom alone represents 71.8 percent of the market of NCIs in 2008

950 Due to absence of data on the number of NCIs operating within the EU, It is assumed that the number of market participants of NCIs is proportionate to the market share with the EU, namely 5,9% percent. Under this assumption this market share is applied to the total number of market participants including 8°357 credit institutions and 13°300 credit intermediaries.

951 See footnote 66.

credit institutions, Commission services estimate that the number of non-credit institutions would be overrepresented in comparison with the amount of credit institutions (8 357) and credit intermediaries (13 300) which in total amounts to 21 657. Commission services estimate therefore that the amount of non-credit institutions operating within the EU market represents 5 % of this total or approximately 1 000 non-credit institutions.

– Total number of EU mortgage credit intermediaries in 2007: 13 300[952].

– Total staff of EU mortgage credit intermediaries in 2007: about 56 050. This figure is an approximation based on the average of 64 500 (number of staff) and 47 600 (number of staff full time equivalents).[953].

– Weighted average rate of EU defaults on residential mortgages in 2008: 1.43 %[954].

– Number of EU advised sales: Average percentage of non-advised sales over five Member States (France, Germany, Spain, United Kingdom, Sweden) is approximately 30 %.[955] Percentage of advised sales is therefore approximately 70 %.

2. CALCULATION OF COSTS AND BENEFITS FOR CONSUMERS AND SOCIETY

2.1. Benefits

The benefits to consumers and society as a whole come through a reduction in defaults. The policy options lead to a situation where the credit product purchased by the consumer is better suited to his/her needs as well as his/her financial and personal circumstances. This means that, in theory, the level of defaults will fall. Foreclosure rates are also likely to fall as a consequence. It should be noted that although default rates do not necessarily lead to foreclosure as payment holidays and/or rescheduling of debts can all prevent a default leading to a foreclosure, they do contribute to general social and economic disruption.

For the purpose of this impact assessment, defaults will be assumed to have an impact on consumers. In reality, this impact is on society at large as defaults also lead to costs for creditors as well as consumers. However, allocating the costs of defaults between consumers and other stakeholders is not feasible, thus it is assumed that all the costs of default will be borne by consumers and society at large.

It is therefore assumed that the policy options impact on the level of the default rate, by reducing it by a certain number of basis points. The EU weighted average default rate in 2007 was 1.43 % (2007 is used because it is assumed to be a more 'normal' rate than 2008 which is biased due to the effect of the financial crisis). The policy options will therefore reduce the default rate by a certain number of basis points. The value of this decrease in the default rate is the reduction in the number of basis points times the annual gross value of mortgage loans (EUR 1 244 966 million in 2007). The benefit for consumers and society therefore should be

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952 See footnote 6.

953 See footnote 6.

954 Calculations by Commission services, see Annex 1, Section 5.1 for further information.

955 Based on an online survey of 2 500 individuals in 2006. See *European mortgage distribution: changing channel choices*, Fortis, EFMA and Oliver Wyman, 2007.

interpreted as the total value of mortgage credits, expressed in euro, which is expected not to default due to the policy measure. Since the positive effect on default rates is expected to continue over the years for all policy options, the calculated benefits are to be considered as annual benefits.

However, calculations following this reasoning offer only a rough estimation of the expected benefits. On the one hand, these benefits may be underestimated because no consideration has been given to the other economic and social costs linked to the default and that will be avoided. These additional costs are, for example, the legal costs linked to the often lengthy foreclosure procedure[956] and the social cost for the borrower of loosing his/her home. There is also the uncertainty for the creditor as to whether the lent amounts will be recovered (particularly in the event of declining houses prices) and for the borrower as to whether he/she will be able to find another decent home. On the other hand, our calculation risks also overestimating benefits. Indeed, foreclosed properties will most often be sold and their sale value would then partially compensate for the credit loss. Given these opposite effects on the expected benefits, we have therefore decided to adopt a prudent approach regarding the estimated default rates reductions. The applied reductions (see Table 1) are therefore quite conservative estimates.

Other benefits have been impossible to quantify but have been described in qualitative terms in this document. These benefits are not quantifiable due to the lack of data, e.g. on consumer behaviour, price elasticities, etc. For example, consumers will frequently accrue benefits through the increased comparability of mortgage offers. As a result, consumers should increasingly compare offers and shop around for a better product and deal for their needs. This should increase competition between creditors and put down the costs/prices paid by the consumer. Similar impacts could be expected from policy options that encourage creditor and credit intermediaries' cross-border activity. Likewise, diminished difficulties in payments (and recurrent arrears) are another set of benefits that are difficult to quantify.

Table 1: Default rate reductions by policy option (in basis points)

Policy option	Basis point fall
Advertising and marketing	
1: Do nothing	0
2: Application of Article 4 of the CCD	Small: 0.5–1
3: Specific rules on the format and content	Small: 1–1.5
Pre-contractual information	
1: Do nothing	0
2: Ensure that consumers receive the ESIS	Medium: 2.5–5
3: Ensure that the ESIS is provided in sufficient time to enable consumers to shop around	
3.1: Principles-based requirement	Small: 0.5–1
3.2: Specify a deadline for the provision of information	Small: 1.5–2.5
4: Improve the format and content of the ESIS	Medium: 2.5–3.5
5: Standardise the Annual Percentage Rate of Charge (APRC)	
5.1: Standardise on the basis of a narrow definition	Small: 0.5–1.5
5.2: Standardise on the basis of Article 19 of the CCD	Small: 1.0–2.0
5.3: Standardise on the basis of a broad definition	Small: 1.5–2.5
6: Additional pre-contractual information	Small: 1–2

956 This can last up to 7 years. *Study on the efficiency of the mortgage collateral in the Europe Union*, European Mortgage Federation, 2007.

Advice and explanations	
1.1: Do nothing	0
1.2: Requirement to provide adequate explanations (Article 5(6) of the CCD)	Medium: 2.5–3.5
1.3: Principles-based advice standards	Medium: 3–4
1.4: Requirement to provide mortgage advice	Medium: 4–5
2.1: Do nothing	0
2.2: Principles-based guidance on remuneration policies	Medium to high: 4–6
2.3: Specific restrictions or caps on methods and levels of remuneration	Medium to high: 4–6
Creditworthiness assessment	
1.1: Do nothing	0
1.2: Requirement for the creditor to assess the borrower's creditworthiness	High (upper range). 10–15
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	High (upper range). 15–20. But includes the previous option benefits
1.4: Non-discriminatory access to databases for creditors	Medium: 3–5
1.5: Homogenise the content and characteristics of databases	Medium: 2.5–3.5
Suitability assessment	
2.1: Do nothing	0
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered	High: 7–9
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	High: 8–10. But includes the previous option benefits
2.4: Requirement for the borrower to provide correct information on his/her situation	Small: 1–2
2.5: Specific product regulation including bans or caps on certain credit products	High: 6–8
Credit intermediaries	
Authorisation and registration	
1.1: Do nothing	0
1.2: Principles-based requirements	Small: 0.5–1
1.3: Specific requirements	Small: 1–2
1.4: Introduce a passport	Small: 0–0.5
Prudential requirements and supervision	
2.1: Do nothing	0
2.2: Principles-based requirements	Small: 0.5–1
2.3: Specific requirements	Small: 0.5–1.5
2.4: Introduce EU level supervision	Small: 0–0.5
Non-credit institutions	
Authorisation and registration	
1.1: Do nothing	0
1.2: Principles-based requirements	Small: 1–2
1.3: Specific requirements	Small: 1.5–2.5
1.4: Introduce a passport	Small: 0–0.5
Prudential requirements and supervision	
2.1: Do nothing	0
2.2: Principles-based requirements	Small: 0.5–1
2.3: Specific requirements	Small: 0.5–1.5
2.4: Introduce a passport	Small: 0–0.5

2.2. Costs

Consumers and society may also incur a cost in the form of reduced access to credit. While the mainstream access to credit should not be affected by these proposals, certain vulnerable groups may face a reduced access to credit as a result of some of these proposals. The size of this reduced access to credit is not quantifiable on an EU-wide basis for two main reasons. First, there is a severe lack of data, particularly on an EU-wide basis, on the accessibility of mortgage credit to different borrower groups, e.g. high loan-to-value lending. Second, it is difficult to attribute the causes for more restricted access to mortgage credit to the proposed policy options alone. Access to mortgage credit can reflect numerous other effects such as the availability of finance to the creditor or housing market developments. In addition, reduced access can be both due to less irresponsible lending or reduced lending to certain groups regardless of their individual creditworthiness. In the latter case, it can be considered as a cost but in the former it would not since it would be one of the reasons why defaults decrease.

However, the cost for (certain categories of) consumers of reduced access to credit will be counterbalanced by two positive impacts. First, for those borrowers who do have access to credit, the cost should be lower as the 'good' borrowers will no longer be paying a higher interest rate to cover the costs of 'bad borrowers' defaulting (moral hazard). Second, consumers that would be denied credit may – in the long run – end up being better off as a result of the denial of credit as they would have avoided the broader negative consequences of overindebtedness and the negative social and economic effect of losing their home.

Where national data is available on the impact of individual policy options on the access to credit, it is provided. It should not however be viewed as indicative of the impact on the whole EU.

3. CALCULATION OF COSTS AND BENEFITS FOR CREDITORS AND CREDIT INTERMEDIARIES

Creditors and credit intermediaries face one-off and recurring costs.

3.1. One-off costs

One-off costs consist of the costs of training staff as well as the costs of adapting IT and other systems, standard operating procedures, etc.

It is assumed that a one day training of 8 hours would be organised covering all four of the pre-contractual topics covered: advertising and marketing; information, advice; and creditworthiness and suitability. It is assumed that this 1-day training would be divided into 4 sessions of 2 hours each. In addition, it is assumed that additional specialist training on creditworthiness and suitability, and advice would be required. It is assumed that an additional training of 6 hours each would be required; 8 hours (6+2 hours) training is therefore estimated for creditworthiness/suitability and advice.

Most policy options will also require IT and systems adjustments as well as changes to the standard operating procedures, etc. In this case, a certain number of man days is assumed. The cost per institution is calculated using the number of man days and the hourly wage.

In some instances, additional one-off costs are calculated. The introduction of authorisation and registration requirements for credit intermediaries and NCIs is expected to generate a one-off cost in terms of a registration fee to be paid to the competent authorities which could amount to EUR 2 500 for non-credit institutions and EUR 1 500 for credit intermediaries[957].

[957] Based on data of the United Kingdom, which requires for straightforward applications GBP 1 500, for moderately complex GBP 5 000 and for complex GBP 25 000. It is considered that credit intermediaries are straightforward applications, and that non-credit institutions are only slightly more complex. See http://www.fsa.gov.uk/pages/Doing/How/help/faqs/index.shtml.

3.1.1. *Recurrent costs*

Recurring costs vary according to the policy initiative. The main cost for providers is the cost of checking compliance for new regulation. In general, it is assumed that 10 % of mortgage credit transactions will be checked for compliance and that this check will take approximately half an hour.

For advertising and advice, this compliance cost is considered negligible as there are already some compliance checks necessary for other legislation such as the unfair commercial practices Directive (2005/29/EC). For remuneration, it is likewise assumed there would be no incremental recurring costs as the new rules will be taken on board and will be executed within the existing remuneration processes.

In addition, recurring cost are attributed as new rules on creditworthiness and suitability are expected to ensure that these assessments are carried out by credit institutions. Therefore a timeframe and corresponding cost of half an hour of interaction per mortgage credit is attributed to creditworthiness assessment and half an hour per 'non-intermediated' transaction for suitability assessment. The same approach is applied for information which is assumed to lead to half an hour interaction with consumers per mortgage credit to provide the information to consumers. For Member States with rules in place on it is assume there are no incremental cost for the creditors and credit intermediaries to ensure compliance.

For authorisation and registration of credit intermediaries, non-credit institutions, recurring costs will be linked to a yearly fee that will need to be paid to the competent authorities to maintain their authorisation. This fee would amount to EUR 1 000[958] per year. In addition, prudential requirements are expected to lead to recurring costs both for credit intermediaries and non-credit institutions. In addition, if Member States could require credit intermediaries and non-credit institutions to hold minimum capital. For the purpose of this impact assessment, this is not taken into consideration as the costs are related to Member State rather Commission action.

3.1.2. *Benefits*

For mortgage credit providers, more harmonised rules across the EU are expected to bring benefits by facilitating market access and increase cross-border activities due to economies of scale and scope which would lower the costs of operating cross-border and an increase consumer confidence in foreign providers. However, while these benefits are expected to materialise as a result of implementing the full package of measures, they have not been quantified for the purpose of this impact assessment due to lack of data on expected cross-border growth of volumes and prices and other factors influencing cross-border activities of mortgage credit providers.

958 Based on data of the UK Financial Services Authority, which requires an annual minimum fee of GBP 1 000 to maintain authorisation. See http://www.fsa.gov.uk/pages/Doing/How/help/faqs/index.shtml.

3.2. Calculation of costs and benefits for Member States

3.2.1. One-off costs

With the exception of self-regulation, where Member States will not incur any costs, all other potential policy instruments will result in Member States incurring costs in terms of developing and/or incorporating rules into national law. According to a recent study, the costs of developing and/or incorporating rules into national law are low to moderate. These costs are therefore estimated at EUR 23 529 per Member State.[959] This figure is based on the responses of Member States to stakeholder surveys.[960] Due to the relatively small number of responses, the highest figure provided has been applied to all countries to generate an upper boundary.[961] It is also assumed that the development/incorporation of these rules is undertaken by the existing regulator.

In several instances, Member States already apply or intend to apply the proposed rules. It is therefore assumed that under such circumstances, these Member States will not incur incremental costs. The discount for one-off costs is not related to the size of the mortgage market but to the relative number of Member States who have/have not the relevant policy in place. In some instances, for example, under certain policy options for credit intermediaries or NCIs providing mortgage credit, further one-off costs will be incurred, for example, establishing a register. A description of the calculation of these one-off costs is provided under the respective sections.

3.2.2. Recurrent costs

Member States will face recurrent costs in terms of monitoring and enforcing the rules. The costs of this are estimated as follows.

– X number of hours times average hourly wage times the total number of market participants.

– X number of hours. Estimates are provided for 1, 2, 3 hours for each policy option.

– The average hourly wage is EUR 31.56 (see above).

– The total number of market participants varies depending on whether the policy option is applied to creditors, credit intermediaries, NCIs providing mortgage credit, etc.

In several instances, Member States already apply or intend to apply the proposed rules. It is therefore assumed that under such circumstances, these Member States will not incur incremental costs for monitoring and enforcing the rules. The discount for these recurring costs is not related to the size of the mortgage market but to the relative number of Member States who have/have not the relevant policy in place.

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959 See footnote 136.
960 See footnote 136.
961 See footnote 136.

3.2.3. Benefits

Member States are expected to incur benefits due to the decrease in defaults among consumers as this is expected to lead to fewer social costs for dealing with defaulted consumers. Reductions in expenses can be expected in social housing, debt relief and debt expenses, psychological support to citizens and direct financial aid.

3.3. Calculation of cumulative impacts

In order to determine an overall impact of the package of preferred options the cumulative impacts has been determined. Following assumptions and methodology was applied.

– The cumulative impact was determined in a two-step approach. In a first instance, the cumulative impact was determined for each policy area, offering a minimum and maximum range for both costs and benefits.

– Minimum and maximum one-off and recurring costs for mortgage lenders and intermediaries for the credit intermediaries and non-banks related options have been calculated by adding up the costs of the retained options. It is assumed that these figures do not contain overlapping costs or synergies. For the other issues (advertising, pre-contractual information, advice and creditworthiness/suitability) it has been assumed that costs are in the majority of cases overlapping for a given policy area.[962] Thus, only the minimum and maximum costs from the most potentially costly option for each policy area have been taken into account for the cumulative impact.

– Minimum and maximum recurring benefits of the retained options are expected to reinforcing each other. As such, a prudent approach has been applied with only the (minimum and maximum) recurring benefits of the option with the most material impact by policy area (advertising and marketing, pre-contractual information, advice and explanations, etc.) has been taken into account for the cumulative impact. This approach most likely underestimates therefore the potential beneficial impact of the package.

– In a second step the total cumulative impact is determined as a sum of minimum and maximum of costs and benefits of each of the policy areas.

[962] E.g. training costs, IT costs and other compliance costs for the different options within the same policy area are in most cases overlapping.