

## **EFIN preparation document for the meeting planned for 13 September 2010 at 10.00 at DG Market.**

Based on the following working paper:  
22.7.2010

### *COMMISSION SERVICES WORKING DOCUMENT*

#### *Responsible Mortgage Lending and Borrowing*

#### **General operating conditions**

Given the variety of actors involved in the mortgage credit granting process, it is essential that uniform quality standards are in place.

**EFIN : Right – the regulation should focus on the « financial service and product » and therefore apply equally for any kind of providers. This reduces the risk of competition distortion between providers as well as uncertainty for the consumers. It also simplifies the legal environment and makes the market and the products easier to understand**

#### Conduct of business

Creditors and credit intermediaries should act **honestly, fairly and professionally** in the best interests of their clients.

The manner in which creditors remunerate their staff and the credit intermediaries with whom they work should not impede this obligation to act in the best interests of the consumer.

#### Minimum competence requirements

Credit intermediaries and creditors' staff should possess appropriate knowledge and competence in relation to credit agreements, and any ancillary services provided with those credit agreements. Such knowledge and competence should be assessed on the basis of recognised qualifications and experience, and complied with on an ongoing basis. The criteria for meeting the competence requirements should have been made public by the Member State. These provisions need not apply to all natural persons who work for a creditor or credit intermediary.

#### **EFIN comments:**


**Using abstract concepts like “honestly, fairly, professionally” is not operational. On such concept, any authorities (financial authorities, at national level) will not be able to implement an effective control of the credit intermediaries behaviour. The EU should invite each member states to translate in an operational way those concepts, operational meaning that the authorities can control efficiently the credit intermediaries.**

**Honestly:** 

To improve consumer protection in mortgage borrowing, we recommend to include examples when abstract concepts are used.

Some key-points:

- the generalised adoption of the voluntary code of conduct on pre-contractual information for home loans and supervision about its pre-contractual use.
- switching process
- consequences for consumers in case of arrears or default payment
- unfair Tying practices (mainly mandatory insurance with captive insurer).

**Fairly**  This term should be « objectively » defined by the law, in order to be legally operational. What is fair related to? The maximum interest rate ? the conditions and terms ? the variability and changes in the terms and conditions (Who can decide of the changes? Some of them could be negociated? Change should be limited in order to maintain the creditworthiness in the long term? Capacity to break / terminate the contract when charges are so high/heavy that the instalments are not affordable anymore ), the ways used for the money collection, the protection of human dignity?

**Professionally**: staff should know the products and be able to assess if it fits the client (Purpose and credit type? Financial capability?). The assessment should be done on objective criteria, not influenced by remuneration methods employed by creditors.

Staff and creditors should be legally responsible for any deviation from the above criteria.

Independent advice: clients should be able to access independent advice

**Working in the best interest of the Clients**: The natural tendency is to first work in your own individual interest and then in the companies interest and lastly in the clients interest. This is only natural, no matter what the intentions may be. Will only work in the interests of clients if it is transparent when one does not (clients need to be fully aware of their rights) and if there is some sort of penalty or reprimand.

## Advertising and marketing

Unfair, unclear or misleading advertising and marketing of mortgage credit may lead consumers to enter into inappropriate credit contracts. In particular, false promises and/or the withholding of important information could mislead consumers as to the availability of the credit to them, or the price at which it is offered. If insufficiently warned, consumers may not be aware, for example of the risks borrowing in a foreign currency.

The introduction of rules concerning general principles for marketing and advertising communications and the content of information to be included in advertising for mortgage products could help safeguard consumers from entering into loans under potentially false pretences.

These measures would be without prejudice to the Unfair Commercial Practices Directive.

**EFIN : Right. Changes in conditions, variable interest rate, special promotion have been reported to be able to confuse the consumers and lead to use difficulties (arrears, defaults).**

**Regarding**

**Mortgage credit in foreign currency, one needs to point out the currency fluctuation and possibly higher burden for debtor (people are not aware of that) and necessity to explain risk factors to the borrower.**

**This lead to a general remark on the final purpose of a mortgage loan. If this financial product is really designed to allow individuals and households to access housing (one of the human basic needs), it should be designed in order to maintain the original (pre-contractual assessment) creditworthiness as much as possible in order to reduce risk of default. The industry should create products than can both reduce the risk on the credit for them and for the clients.**

**In this perspective, mortgage credit in foreign currency seems to increase the risk of fluctuations and should therefore be considered with high precaution.**

## General provisions

Any advertising and marketing communications concerning credit should be complete, fair, clear and not misleading.

Wording that may create false expectations for a consumer regarding the availability or the cost of a credit should be prohibited.

## Standard information to be included in advertising

Any advertising concerning credit which indicates an interest rate or any figures relating to the cost of the credit to the consumer should include standard information. This information should be easily legible or audible and be given in a clear, concise and prominent way.

It should specify that the product advertised is a credit. It should include the borrowing rate, the annual percentage rate of charge together with the cost of any compulsory ancillary service, the duration of the credit agreement, the amount of the instalments, the total amount payable by the consumer and, if applicable, the maximum percentage of the value of the immovable property that could be financed with the credit. Where applicable, it should contain a warning that the credit is denominated in a foreign currency.

It should contain a warning concerning the risk of losing the immovable property in case of non-observance of the commitments linked to the credit agreement.

**EFIN : Right.**

**To much information kills the information, therefore, standardised information with an appropriate wording is essential.**

**Explanation of repayment schedule shall also be attached to the contract. For credit with variable interest rate, example of realistic changes should be presented.**

**In order to render effectivee this provision, it should be completed by periodically inspections by ad-hoc authorities (or Mistery Shops).**

**Promotional offers and short term discounts should be strictly regulated because it can lead to misunderstandings and can trigger difficulties for the borrowers (repayment capacity..., high costs when arrears...).**

## **Information and explanations**

Complex, non-comparable, unclear and untimely pre-contractual information does not help consumers in their borrowing decisions. The contractual links between creditors and credit intermediaries, and the way in which the intermediaries are remunerated may incentivise the recommendation of products that may not be suitable for the client. The consumer should be provided – in good time – with general information on the credit offers as well as personalised information.

The content and layout of the standardised presentation of pre-contractual information, the European Standardised Information Sheet on Home Loans that has been in place under a self-regulatory Code of Conduct since 2001, would be adapted to identified consumer needs and in line with the results of prior consumer testing. Its status would be upgraded to a compulsory element of the loan transaction.

It is also envisaged for information to be disclosed on credit intermediaries. This would focus on their identification, status, remuneration, the cost of their service and the relationship with the lender. Some of this information would be provided solely at the consumer's request.

The consumer should be given adequate explanations by the creditor or the credit intermediary, according to his knowledge and experience with credit, and therefore be put in a position to assess whether the proposed credit products are adapted to his needs and to his financial situation.

These measures would help consumers to shop around and empower them to make informed decisions.

The content of a possible European Standardised Information Sheet for Mortgage Credit can be found as an annex to this document.

### **Pre-contractual information**

#### **Information requirements concerning credit intermediaries**

**EFIN : the credit intermediaries should provide to their clients a file (a table ?) in which they will find the various credits that had been checked for his client. This file bring therefore a transparent information on the provision done by the intermediarie for the client, and is the base on which which will illustrate the reason of his advice. For each product that has been checked, the intermediarie could also add the fee that he will receive.**

**At this stage, we consider that the cost of advice provided by intermediaries should become transparent. The client should know that advice has a cost, because in the long term, this will create new opportunities for intermediaries professionals to create new business, and maybe increase the quality and the independancy of the advices provided thanks to an improved competition and transparency in the market.**

**For the rest : NO COMMENT**



## **Creditworthiness and suitability assessment**

Inadequate creditworthiness and suitability assessment can lead to situations in which borrowers may take on mortgages loans that they will not be able to afford or that are not suitable for their personal situation.

Before granting a mortgage credit, the creditor should assess the consumer's ability to repay it (creditworthiness assessment), taking into account the consumer's personal circumstances such as his income, regular outgoings and any other elements that may influence his ability to repay the loan such as tax relief or other subsidies. The creditor should also ensure that the credit product is appropriate to consumer's personal and financial circumstances (suitability assessment). The allocation of responsibilities between the creditor and the credit intermediary as regards the suitability assessment should be made clear.

These principles should be accompanied by adequate provisions likely to ensure that lenders are able to access information from relevant sources, such as an obligation for Member States to grant non-discriminatory cross-border access to credit databases and an obligation on the consumer to provide correct and up to date information.

Mortgage distributors could also be obliged to refuse to grant the loan in case the results of the creditworthiness assessment do not give sufficient comfort that the consumer will be able to repay it. They should provide a warning in the event of a negative suitability assessment and if the consumer insists on proceeding with the contract.

In order to facilitate the effective exploitation of credit data, further work might be necessary to achieve a convergence of the definitions used in such databases and data processing conditions applied in such databases.

This package of measures could contribute to better lending and borrowing decisions, a reduction in defaults by borrowers and thereby play an important role in overall financial stability.

### Creditworthiness assessment

Before the conclusion of the credit agreement, a thorough assessment of the consumer's creditworthiness should be conducted by the creditor on the basis of sufficient information obtained from the consumer, relevant internal or external sources and in accordance to appropriate processes. The consumer's creditworthiness should be re-assessed before any significant increase in the total amount of credit.

If the results of the consumer's creditworthiness assessment are negative, the creditor should deny credit.

If the credit application is rejected on the basis of the data contained in a database that has been consulted or of an automated decision or a decision based on systematic

methods such as credit scoring, the creditor should inform the consumer immediately and without charge of the reasons for rejection.

**EFIN: the budget file elements (eg: income, monthly fixed expenditures, credit repayments, new credit repayment, available amount remaining for the variable expenditures) should be completed and kept in the credit file. If the creditor is responsible for collecting the information, the client must provide true and complete information and the file completed should be appropriate to determine the responsibility in case of difficulties.**

**In order to implement a tool aimed to measure operational responsible behaviour of creditors and debtors, the credit file should therefore be designed to clarify and identify responsibilities of each party. This files and elements included should be prove the conduct of the two contractors.**

**Moreover, sole reliance on automated credit scoring or on a database should be insufficient as cause for rejection. The applicant (borrower) must have recourse for correcting information that might be incomplete or not reflecting the real circumstances (e.g. living in a shared household where one member has debts but the applicant is not responsible for those; inaccuracies in the database etcetc). Credit scoring is frequently too static to be universally applicable, and as the methods for credit scoring are rarely disclosed, it is also very intransparent.**

**Responsible lending include also the commitment to explain why the creditworthiness is poor and the risk of overindebtedness high.**

**Remark: assessing creditworthiness is relevant if it is done in a long term view (beside temporal promotion, for example). We underline the fact that any contract that allow important changes in the monthly repayment make creditworthiness assessment inefficient to protect the providers as well as the client that the credit will be repaid properly. It would be therefore responsible to design credit products that reduce this risk by a way or another.**

### Suitability assessment

**EFIN: We consider the following paragraph** « If the consumer insists to contract a credit agreement that the creditor or intermediary has identified as being not suitable for his circumstances, he should be warned of its unsuitable nature. This warning should be signed for receipt by the consumer.

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**It is FULLY incompatible with responsible behaviour / responsible credit behaviour, from both side (client and creditor). We know that for many individuals or households, getting a credit appears to be essential, given their life circumstances whereas in reality, it is not. If the appropriate measures to assess the creditworthiness and opportunity of the credit can be so easily eliminated (and especially, the creditors' responsibility!), the risk is that such a « warning » will become part of the procedure, of the document included in the credit file ....It also makes the whole exercise of responsible credit superflous – if the credit is unsuitable, then they should not access/use that product.**

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### Advice



As set out in the glossary, advice should be understood as the provision of a personal recommendation to a consumer on suitable credit products for that consumer's needs and circumstances, either upon his request or at the initiative of the advisor.

Provisions on advice will not render it compulsory. It should constitute a separate financial service from the granting of the credit. Nevertheless, in those cases where advice is given, it should be possible to ensure that it is given in as objective a manner as possible and in line with the profile of the borrower.

### Advice standards

The advisor should consider a sufficient selection of available credit agreements in the preparation of his recommendation, in order to recommend the most suitable credit product for the consumer's needs, financial situation and personal circumstances.

The advisor should obtain the necessary information regarding the consumer's personal and financial situation, his preferences and objectives to enable the advisor to recommend to the consumer the credit agreement that is most suitable for him.

**EFIN: As suggested before, the list / table of the products compared and the criteria took into account to build the advice should be provided to the client.**

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### Annual Percentage Rate of Charge

The APRC is the main indicator used for the comparison of mortgage credit offers. A common understanding throughout the EU of both the list of costs to be taken into account and the calculation method is therefore useful.

In view of the fact that the definition of the APRC as adopted under the Consumer Credit Directive is often also applied to mortgage credit, and in order to facilitate comparison between the two types of credit, the definition to be considered here should be as close as possible as that used in the CCD.

### APRC Calculation

The annual percentage rate of charge, equating, on an annual basis, to the present value of all commitments (drawdowns, repayments and charges), should be calculated in accordance with a mathematical formula (this formula would be the same as that annexed to the Consumer Credit Directive).

The total cost of the credit to the consumer should be determined, with the exception of any charges payable by the consumer for non-compliance with any of his commitments and charges other than the purchase price which he is obliged to pay.

Costs for a payment account should be included in the total cost of credit to the consumer unless the opening of the account is optional and the costs of the account have been clearly and separately shown elsewhere.

The calculation of the annual percentage rate of charge should be based on the assumption that the credit agreement is to remain valid for the period agreed.

In the case of variable rate agreements, the APRC should be calculated based on the initial level.

#### Updates on the borrowing rate and APRC

The consumer should be informed of any change in the borrowing rate or the APRC, on paper or another durable medium, before the change enters into force. The information on the borrowing rate should state the amount of the repayments to be made after the entry into force of the new borrowing rate and, if the number or frequency of the payments changes, particulars thereof.

The parties could agree in the credit agreement that this information should be given to the consumer periodically in cases where the change in the borrowing rate or the APRC would be caused by a change in a reference rate, the new reference rate is made publicly available and the information concerning the new reference rate is also kept available in the premises of the creditor.

**EFIN: We consider that within this section dedicated to the change in the borrowing rate or the APRC, it should be adequate to define limits in which such changes can be considered as « fair ». We consider that too relevant and unfavourable changes in the monthly instalment may give rise to « toxic loans», because such changes influence an essential element of the contract (the cost) that may not fit anymore with the initial creditworthiness of the client. In this situation, the client may be in a position where he can not afford the liabilities anymore. One should think about other kind of adjustments that should be provided/proposed in order to avoid such use difficulties, which can have a severe impact on the housing market (see the financial crisis). This issue leads to reflexion about the practices that link interest rate to LIBOR or EURIBOR. If so, the changes may be not limited – no one may agree on that. The only solution to determine the highest possible interest rate is to attach cap contract to the credit**

**Legislation about borrower bankruptcy should be better harmonized and provide effective tools to borrowers in order to prevent their bankruptcy in case of significant changes in the cost of borrowing, notably when substitution of credit is not possible/affordable.**

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#### **Prudential and supervisory requirements**

One of the core pillars of the envisaged action would be to establish principles for a regulatory and supervisory framework for credit intermediaries. It would allow for the authorisation and registration of credit intermediaries (subject to compliance with certain prudential requirements on entry into the business and on an ongoing basis) and for the creation of a passport regime for credit intermediaries. This would bring the framework at EU level for the intermediation of credit in line with that already in place for the intermediation of insurance or financial instruments. Coherence and compatibility between the envisaged actions for credit intermediaries are sought with existing requirements for the other financial sectors.

The action would also aim to achieve a more level playing field for creditors, whereby Member States should ensure that all creditors, including non-banks, are subject to appropriate regulation and supervision. It would not go into detail on how this should be achieved. In view of the limited number of Member States in which non-bank creditors are active and their small market share, a passport regime for non-banks is not envisaged.

### Registration of credit intermediaries

Credit intermediaries should be registered with a competent authority in their home Member State. Member States may allow for creditors' trade organisations and other bodies to collaborate with the competent authorities in registering credit intermediaries and in the application of prudential requirements of to such intermediaries.

The registration should cover legal persons, and also include the names of the natural persons within the management responsible for the intermediation business.

More than one register for credit intermediaries could be established, provided that criteria are laid down according to which intermediaries would be registered and authorised.

The various registers should be accessible quickly and easily through a single information point, which should be compiled electronically and kept constantly updated. This information point should also provide the identification details of the relevant competent authorities. The register should also indicate the Member State(s) in which the intermediary would be authorised to conduct business.

### Authorisation of credit intermediaries

Credit intermediaries should be authorised by a competent authority in their home Member State. This authorisation of credit intermediaries – including tied ones – should be made subject to the fulfilment of professional requirements.

Credit intermediaries duly authorised by their home Member State authority should be allowed to take up and pursue the activity of credit intermediation in the Community by means of both freedom of establishment and freedom to provide services without a requirement for further authorisation by the host Member State authorities.

If the credit intermediary no longer fulfils the requirements under which authorisation had been granted or had obtained the authorisation through false statements or any other irregular means, its authorisation should be withdrawn.

**EFIN : in order to ensure an appropriate market integration, a EU common minimum list of requirements to be fulfilled should be designed. There should also be a EU minimal and common list setting out of irregularities in order to avoid that some bad practices can be developed in some EU countries where regulation is less restrictive (illegal interest rate / illegal terms and conditions, undue penalties) or where effective controls on fair, honest and professional business conduct of the financial providers are weaker.**

**Common EU rules will be limited to a minimal base of requirements. A result may be achieved with a supervision of the providers with respect of the avoidance of bad practices. There must be protection rules at national level of the borrowers, based on EU rules.**