

Preliminary EBF position on the Proposal for a Directive on credit agreements relating to residential property

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

Key Points

Achieving further integration in the retail mortgage credit markets

The EBF welcomes the aim of the Proposal for a Directive on credit agreements relating to residential property ('The Proposal') to ensure an efficient and competitive internal market by restoring consumer confidence, removing barriers to cross-border activity and promoting level playing field between actors. While the EBF supports that objective, the EBF is not convinced that it could be achieved by the current Proposal for the reasons explained in paragraph 1.1 to 3.1.

1.1. Recital 5 of the Proposal states: *'a harmonised Union framework needs to be established in a number of areas'*. In this context, the EBF is convinced that it is of utmost importance to ensure that the level of harmonisation does not result in gold-plating practices creating obstacles to the functioning of the internal market. The EBF is confident that a full targeted harmonisation approach, i.e. harmonisation of key elements regulating credit agreements relating to a residential property - consistent with the already established by Directive 2008/48/EC (the Consumer Credit Directive) regulatory framework - will genuinely promote a level playing field and consumer protection in the EU. However, since the specific features of the residential mortgage credit markets have to be taken into account, a departure from the principle mentioned above should be allowed only when strictly necessary.

2.1. Recital 3 of the Proposal states: *'The financial crisis has shown that irresponsible behaviour by market participants can undermine the foundations of the financial system'*; *'consumers have lost confidence'*; *'defaults and forced sale rising'*. The EBF would like to reiterate its position¹ on the fact that the problems in the EU were not so widespread as in the US mortgage credit markets. As acknowledged in the Impact Assessment accompanying the Proposal, data may also have been influenced by other factors such as the general economic downturn.

¹ EBF response to the Consultation on Responsible Lending and Borrowing in the EU- available at: <http://www.ebf-fbe.eu/uploads/documents/positions/RetailFinance/Responsible%20Lending%20and%20Borrowing.pdf>.

The EBF recognizes² that some cases of irresponsible behaviour have occurred in a limited number of Member States but most of these Member States have already taken necessary steps and measures to fill in the gaps in their respective legislations and practice. In this context, it should further be also taken into account that default rates are also influenced also by external factors (unemployment, divorce). Considering the above, the EBF members believe that the wording of Recital 3 of the Proposal should be lightened.

3.1. The EBF would like to recall the acknowledgement made by the European Commission in the White Paper on the Integration of EU Mortgage Credit Markets of the supply-driven nature of the mortgage markets and the fact that consumers predominantly shop locally for mortgage credit. In this context, the EBF is not convinced that the current Proposal would enhance the cross-border activity of creditors and credit intermediaries, necessary for the smooth functioning of the internal market.³ Although the current Proposal does not tackle (in the view of the EBF the current Proposal is not the appropriate legislative instrument to do so) the removal of legal obstacles to cross-border opening of residential mortgage markets, such as diverging legal frameworks of access to credit data and land registers, it is possible that in the future an EU intervention in these areas would be advisable.

4.1. It should also be recognized that the efforts made to promote sound, consistent and effective mortgage origination and underwriting practices have recently been noted in the Financial Stability Board's Peer Review Report⁴: *'Overall, national authorities are making good progress in following the Joint Forum recommendations to promote consistent and effective underwriting standards for residential mortgage origination. As a result, industry practices are moving in the right direction.'*

5.1. Moreover, the EBF believes that the discussions on the Proposal should be correlated with the extensive regulatory reforms undertaken in response to the crisis. In particular, the substantial amendments of the prudential rules already adopted and currently under discussion (CDR IV) should be taken into consideration. These reinforced prudential rules aim to contain risk-taking and to ensure appropriate risk-management in the financial institutions in the EU.

Scope – focus on individual consumer protection

6.1. Being focused on consumer protection, the EBF believes that the scope of this Proposal should be limited only to consumers without the possibility for Member States to extend the application to micro-enterprises or a review clause in the Proposal including evaluation on whether small and medium-sized enterprises should be included within its scope in the future. In addition, the EBF takes the view that coherence should be ensured with the exemptions currently in place under the Consumer Credit Directive, including development loans.

² Ibid.

³ EBF observations on the White Paper on the Integration of EU Mortgage Markets – available at: <http://www.ebf-fbe.eu/uploads/documents/positions/RetailFinance/WP%20Mortgage%20Credit.pdf>.

⁴ Financial Stability Board's Peer Review Report – 'Thematic Review on Mortgage Underwriting and Origination Practices' published on 17th March 2011.

Delegated powers – essential elements should not be subject to delegated powers

7.1. The EBF members are concerned by the scope and extent of the delegated powers conferred to the Commission and strongly question whether the areas mentioned herewith are to be considered as non-essential elements of the Proposal: (1) the possibility to specify further the list of standard information items in advertising; (2) to amend the general pre-contractual information items; (3) to amend the content and format of ESIS (European Standardised Information Sheet) (4) to specify and amend the criteria to be considered in the conduct of the creditworthiness assessment; (5) to specify the necessary requirements for appropriate knowledge; (6) the competence in relation to database access and (7) to information requirements concerning credit intermediaries. Moreover, the Proposal provides for the powers to be conferred to the Commission for an indeterminate period of time. In relation to this, EBF members are concerned that although subject to objection within two months of the adoption notification, and revocation at any time by the European Parliament or the Council, it will not be possible for them to propose amendments, nor will the Commission be required to conduct consultations with stakeholders.

Consistency needed with the Consumer Credit Directive framework

8.1. The Explanatory Memorandum of the Proposal states that it should be consistent and complementary to the Consumer Credit Directive by creating a similar framework for mortgage credit. Furthermore, Article 2(1) (c) of the Proposal states explicitly that the Proposal applies to credit agreements, the purpose of which is the renovation of the residential immovable property not covered by the Consumer Credit Directive. The EBF would like to stress that some Member States have already extended the application of provisions of the Consumer Credit Directive to mortgage credit agreements and in some countries consumers are already being provided with advertising and pre-contractual information (incl. the Standard European Consumer Credit Information ‘SECCI form’) based on those provisions. Against this background, EBF believes that in order to avoid additional implementation costs (e.g. administrative costs for staff training, adaptation of systems and materials) and to prevent any possible harm to consumers having to face again new changes in the way in which mortgage credit agreements are being dealt with, key provisions of the Proposal, such as: advertising, pre-contractual information and creditworthiness assessment, should remain as close as possible to the Consumer Credit Directive.

8.2. Considering the above and in order to ensure consistency between the two regulatory frameworks for consumer credit agreements and credit agreements relating to residential property for the future, adaptation to the specific features of the mortgage credit market should be made only in areas where this is strictly necessary. In this context, the EBF believes that the Commission’s attempt to adapt certain provisions of the Proposal to the mortgage credit market features has gone beyond what is necessary for such a purpose, for example, the requirement to: (1) identify products that are not unsuitable; (2) to deny credit in case of negative creditworthiness assessment; (3) to assess accurately the level of knowledge and experience with the credit of the consumer by any means necessary and subsequently to adjust the adequate explanations, and (4) to explain the reasons for the credit application rejection and the logic of the lenders’ automated decision systems. These additional requirements diverge from the regulatory framework for consumer

credit agreements in important aspects, for no apparent reason and without clear benefits for the consumers, creating at the same time difficulties in interpretation, and thus, legal uncertainty regarding their application, with a potential risk of increase in litigation. Against this background and in order to avoid any possible adverse effects on the functioning of the mortgage credit markets, there is a need for clear rules as to which regime applies, and under which conditions, as well as a consistency regarding the exemptions provided, for the time being, only under the Consumer Credit Directive.

Ensure legal certainty

9.1. Furthermore, the EBF would like to emphasize the ambiguous elements contained in a number of provisions and the potential risk of increased legal uncertainty related to them: (1) not to use *'wording that may create false expectations for a consumer'* (Article 7); (2) to *'accurately assess the level of knowledge and experience with credit of the consumer by any means necessary'* (Article 11); (3) *'to identify products that are not unsuitable for the consumer'* and in this context (4) the *'considerations shall be based [...] reasonable assumptions as to the consumer's situation over the term of the proposed credit agreement'* (Article 14(4)). It is impossible for a lender to *'reasonably'* assume what the consumer's situation in the future may be, especially in the context of the evaluation as to which products would not be unsuitable. It is also unclear what exactly *'false expectations'* suggests. The Unfair Commercial Practices Directive, as mentioned in Article 7, has already established terminology and rules in this regard. The wording *'by any means necessary'* could be interpreted by the judicial forums in the different Member States in a different way and result in the application of different standards across the EU. Furthermore, if a Member State imposes conditions on the exercise of the right of early repayment, such conditions shall not make the exercise of the right *'excessively difficult or onerous for the consumer'* (Article 18(2)).

Creditworthiness assessment

10.1. The EBF members believe that the conduct of a creditworthiness assessment is fundamental for the correct functioning of the mortgage credit markets and therefore support the principle-based approach adopted by the Commission. However, the EBF would like to express its concerns regarding the introduction of a legal obligation to deny credit in the event of a negative creditworthiness assessment. The EBF reiterates that a decision to grant the credit is taken on the basis of extensive analysis of the borrower's ability to repay. Although the possibility to refuse to grant credit is already the case in practice the EBF takes the view that given the long-term contractual relationship between the lender and the borrower, it should not be made a legal obligation as this could lead to a potential increase in litigation where national courts would most likely be required to rule on the matter decades after the credit was actually granted.

10.2. It could also entail recognition of a *'right to credit'* in the event of a positive creditworthiness assessment. In this context, the EBF welcomes the fact that in recital 25 the Commission states that a positive creditworthiness assessment does not constitute an obligation for the creditor to provide credit. However, the EBF believes that such wording should be reflected in the Proposal's articles as well.

10.3. According to the Proposal, in addition to the conduct of creditworthiness assessment, lenders are required to identify, based on the information provided by the consumer and on a sufficiently large number of credit agreements from the lenders' product range, products that are not unsuitable for the consumer. Although the EBF recognizes that compared to the initially discussed text there is a positive change in the wording, i.e. the requirement is to identify products that are 'not unsuitable' instead of 'suitable', we still believe that this additional requirement, which is not present in the Consumer Credit Directive, is redundant. According to the Proposal, lenders are already required to provide a substantial amount of pre-contractual information and adequate explanations. As mentioned above (see paragraph 8.2.) such an obligation is not included in Article 8 of the said Directive. A decision of whether or not a loan product matches the borrower's personal situation can be made only by the borrower, placed in the position to take it on an informed basis. The EBF believes that such a requirement is better placed within the rules concerning the provision of advice.

10.4. In this context it has to be noted that the provision of adequate explanations, according to the Proposal should be based on an accurate assessment, by any means necessary, of the level of knowledge and experience with credit of the consumer and adjusted accordingly. As mentioned in paragraph 8.2. the Consumer Credit Directive does not require assessment of the consumer's knowledge and experience with credit and subsequent adjustment of explanations (Article 5(6) of the said Directive). As already mentioned some Member States already apply the Consumer Credit Directive's provision to credit agreements relating to residential property (see paragraph 8.1.). The EBF members are also particularly concerned by the potential difficulties in the interpretation of '*by any means necessary*' which might result in the application of different standards across the EU.

10.5. The EBF has strong reservations regarding: i) the obligation to explain to the consumer the reasons for a credit application rejection; ii) the logic involved in an automated decision, and iii) the obligation to review manually the decision if the consumer requests so. Such obligations could encourage the consumer to question and oppose the rejection of a credit application, as well as stimulate unfair or 'fraudulent' behaviour, based on the information containing the reasons for rejection provided by the lender. As a result, the application could be adapted with a view to having it approved by another lender. It will also force the lender to reveal details on the way in which its internal automated decision systems are structured, as well as sustain the additional costs related to provision of the information mentioned above, and eventually, to the manual review of the rejected credit application. As mentioned above (see paragraph 8.2.) obligations such as an explanation of the reasons for rejection or the logic of automated decisions are not provided by the Consumer Credit Directive, the consumer has simply the right to be informed of the result of the database consultation (Article 5(1) (q) and Article 9 (2) of the said Directive).

Information overload

11.1. The Proposal requires the inclusion of a warning, as part of the standard information in advertising, concerning the risk of losing the immovable property in the event of non-observance by the consumer of the commitments. As part of the personalised pre-contractual information a warning is also included in ESIS - European Standardised Information Sheet - (Section 14). In the view of the EBF members, the warning, being

related to non-observance of contractual obligations should remain part of the pre-contractual information, i.e. Section 14 of ESIS.

11.2. According to Article 9(2) of the Proposal, ESIS has to be provided '*without undue delay*' after the consumer was given the necessary information. Under the Consumer Credit Directive, the SECCI form has to be provided '*in good time*' before the consumer is bound by any credit agreement or offer so that the consumer can compare different offers and make an informed decision (Article 5(1) of the Consumer Credit Directive). In the view of the EBF members, it is appropriate to align the requirements for the provision of ESIS with those of SECCI in the Consumer Credit Directive for the reasons expressed above (see paragraph 8.1. and 8.2). The EBF members also believe that the provision of pre-contractual information should not be subject to gold-plating. Therefore, it is advisable to delete the words '*at least*' in Article 9(1) of the Proposal. The fact that some Member States are already requiring the use of SECCI also for the provision of pre-contractual information for mortgage credit agreements causes some concern that have to be taken into account.

11.3. Although pre-contractual information requirements, both general and personalised, as drafted in the Proposal are generally in line with the Voluntary Code of Conduct on pre-contractual information for home loans, it should be noted that the provision of information in the current Proposal differs from the one in the Consumer Credit Directive already extended in some Member States to mortgage credit agreements. While the Consumer Credit Directive relies on the provision of three-level information consisting in (a) specific pre-contractual information (b) supplementary pre-contractual adequate explanations and (c) contractual information, the Proposal includes four-level information requirements where, even before the provision of personalised pre-contractual information, a general one should be provided. Without taking a position at this stage, the EBF members believe that this should also be taken into account.

APRC (Annual Percentage Rate of Charge)

12.1. The EBF has always advocated in favour of harmonising the Annual Percentage Rate of Charge (APRC) on a narrow cost base since this is the only way to ensure an increase in comparability. Indeed, basing the APRC on the definition of '*total cost of credit*' could be at the detriment of the consumer as pricing will not be comparable. However, we understand that the Commission's intention is to apply to credit agreements relating to a residential property, the Consumer Credit Directive's definition of the '*total cost of credit*'. Indeed, Article 3(k) of the Proposal refers explicitly to the definition in Article 3(g) of the Consumer Credit Directive which already excludes notarial costs. However, the conclusion of credit agreements relating to a residential property involves other costs which are not incurred when taking-up a consumer credit. Lenders have no influence on these third-party costs, and often will not even be aware of the amount involved. This considered, the EBF would like to stress that reference to the definition of '*total cost of credit*' of the Consumer Credit Directive would be acceptable, provided that costs associated with the provision of the security for the credit agreements relating to residential property (e.g. fees for registering the property charge in the public land registry) are not part of the definition of the '*total cost of credit*'. As mentioned above, we still have important doubts about the added value for consumers to include insurance premiums in the total cost of credit. Quite often, the insurance premiums would not be

known to the lender (for example, if not within the same group) and therefore could not be included; at the same time adding them only when they are known will mean that APRCs are not at all comparable. At least, the EBF would seek clarification that costs related to ancillary services, such as insurance premiums, are to be included, only if known to the lender, and if compulsory in order to obtain the credit or obtain it on the terms and conditions marketed. Moreover, costs relating to property valuation, not known by the lender, should be excluded.

Advice as a separated service

13.1. The Proposal sets out a MiFID-like obligation to act in the best interests of the consumer and a conflict of interest rule on remuneration - not only in relation to granting, intermediating or advising on credit but also in relation to ancillary services, regardless of whether the lender is acting in an advisory function or not. In the view of EBF members, the imposition of such a MiFID-like conduct of business rule, not only in relation to intermediating or advising, but also to granting of credit, will prove to be impracticable. Moreover, EBF members are concerned that once the consumer is no longer able to meet its commitments, he/she may take the opportunity to claim that the conclusion of the contract was not in his/her best interest. As already stated above it is up to the consumer, of course on an informed basis, to take the final decision regarding the taking-up of the credit. If, however, the Commission decides to maintain such an obligation, it should remain, within the provision of advice as a separate service.

13.2. The EBF praises the Commission's acknowledgement of the role which financial advice can play in the mortgage market as a separate service. However, the EBF believes that, in general, the Proposal fails to make a sufficiently clear distinction between a lenders' advisory function and other services (see also paragraph 10.3. and 13.1.).

13.3. In addition to the above, it should be noted that Article 17(2) (a) of the Proposal requires creditors and credit intermediaries providing advice, to '*consider a sufficiently large number of credit agreements available on the market*'. Creditors cannot be expected to consider products of other creditors when providing advice, and therefore, it would be very difficult for them to meet such a requirement.

As a result, in the case of provision of advice by the creditor or a tied credit intermediary, they should be only required to consider sufficiently large number of credit agreements 'within the creditor's product range'.

Right to early repayment

14.1. In the EBF's view the situation with early repayment is very different from one country to another and this should be taken into account in order to avoid adverse effects on national mortgage markets. In case a right of early repayment is granted to the consumer, the right of a '*fair and objective*' compensation for the lender should be recognised. In this context, the EBF is also concerned that Member States, according to Article 18(2), which decide to impose conditions on the exercise of the right of early repayment, should not make the exercise of the right excessively difficult or onerous for the consumer. As already stated, the wording '*excessively difficult or onerous*' could be interpreted by the national courts differently according to each particular situation of default (see paragraph 9.1).

Minimum competence requirements

15.1. The EBF notes as well that ensuring the staff's appropriate level of knowledge and competence in relation to the offering or granting of credit, is a direct responsibility of each credit institution, which must be maintained in this area. Therefore, at most, Article 6 should contain simpler and more generic terms stating that for example, credit institutions shall ensure the appropriate level of knowledge and competence of their staff. Moreover, it does not seem appropriate a delegation of powers to the Commission to specify the necessary requirements for an appropriate level of knowledge and competence.

Regulation of credit intermediaries

16.1. Last but not least, the EBF considers the level playing field as pre-requisite for the correct, sound, and safe functioning of the internal market. With this in mind, we welcome the creation of a regulatory framework for credit intermediaries and the application of the same conduct of business and consumer protection rules to creditors and credit intermediaries.

16.2. Moreover, the EBF also welcomes the acknowledgment made by the Commission of the important distinction to be made between tied and independent intermediaries, notably with regard to the requirements related to the disclosure of commissions and the rules that have to be applied accordingly. In this context, the EBF is also confident that, as already mentioned in paragraph 13.3, the Commission will also take into consideration the fact that in the case of provision of advice by the creditor or a tied credit intermediary, they should be only required to consider sufficiently large number of credit agreements 'within the creditor's product range'.

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