



**HM TREASURY**

## **UK Response to Commission Green Paper on Mortgage Credit in the EU**

### **Overview**

EU mortgage markets constitute an important aspect of the overall economy of EU Member States. Increased efficiency and competitiveness in these markets has the potential to contribute to the overall growth of the EU economy by enabling consumers to enter housing markets, through helping homeowners maximise the value of their housing assets and by facilitating labour market flexibility.

As the Commission's Green Paper makes clear, increased efficiency and competitiveness in EU mortgage credit markets is most likely to be delivered by ensuring that mortgage credit can be demanded and offered with limited hindrance throughout the EU and that market completeness, product diversity and price convergence are enhanced across Member States.

In order to achieve these goals the UK believes that the focus of future work in this area should be shaped by the following priorities:

### **Better Enforcement**

The better enforcement and implementation of existing measures is an important priority. A wide range of existing Directives bear on the ability of mortgage lenders to freely offer financial services at a distance, to structure their businesses appropriately, and undertake a number of specific activities across border, like 'distance marketing'. It is important that all Member States transpose and implement agreed Financial Services Action Plan measures on time.

### **Better Regulation**

The UK strongly believes that priorities for future work should be determined by continued focus on the principles of better regulation. The Commission's commitment to open and transparent consultation to date has been very

welcome and it is hoped this approach will continue when the Commission considers how it might take forward the issues in the Green Paper.

It is important as well that the Commission carries out a convincing economic impact assessment of any proposals. The London Economics study published alongside the Green Paper represents a first step, but is a long way short of the sort of rigorous cost benefit analysis that will be required to justify any specific action.

The UK's recent experience of introducing regulation indicates that the cost of intervention can vary greatly depending on the measure concerned. For example, significant costs arise from intervening on consumer information and advice. At the same time, the evidence suggests that consumers' information and advice needs are closely linked to the legal and cultural landscape of their specific national markets. The UK is therefore sceptical that Commission intervention in this area will prove effective in cost benefit terms, especially given the lack of evidence that action on this front will deliver greater integration.

## **Alternatives to Regulation**

In line with our post-FSAP priorities, the UK believes that alternatives to regulation should be fully explored before any decision is made on legislative interventions in EU mortgage markets.

The Commission's Green Paper itself highlights a number of areas where non-legislative action has begun to address barriers to market integration. The EU Code of Conduct and EULIS project are both examples of alternatives to regulation that have enjoyed some success to date and where there is scope for much more work. The UK also believes that credit data access and mortgage funding would benefit from similar cooperative initiatives. The evidence of EULIS shows that the costs of voluntary action would be modest. But there is real potential to increase market access, by reducing, for example, uncertainty over land ownership and valuation, and lack of access to borrower data. These represent significant barriers to mortgage market integration.

## **Global Nature of Financial Markets**

Whilst mortgage credit markets in the EU are at present very localised, the wholesale markets that increasingly provide the funds for EU mortgage lending are international. Reducing funding costs through increased liquidity in existing markets for national mortgage assets, or through developing a new pan-European markets will benefit consumers through reducing the cost of funding, facilitate product innovation, help extend market completeness and lower barriers to market entry for new lenders.

The UK therefore supports the Commission's willingness to explore the potential of market led initiatives in this area and believes it should be a

priority of work going forward to ensure that the existing diversity of funding options is protected and promoted.

And retail lenders are becoming increasingly active on the world stage too, as they seek growth and efficiency through international mortgage businesses.

## The Commission's Priorities

The need for the Commission to identify particular mortgage priorities is clear. These priorities should be areas where enhanced market access can be achieved using persuasive and voluntary measures, to foster greater collaboration and cooperation.

Given our detailed analysis in part 3, the UK believes the priorities should be

- **Increasing non-discriminatory cross-border access to consumer credit data, while maintaining key data protection safeguards.** This will facilitate market entry for lenders and has the potential to strengthen over-indebtedness strategies.
- **Developing trusted common valuation standards that can be widely used and understood by valuers and lending institutions.**
- **Raising confidence in repossession procedures, while maintaining significant consumer safeguards.**
- **Encouraging the development of EULIS and recognising it as an example of good practice.**

In addition we welcome the recognition of the need for efficient, low cost mortgage funding arrangements in the Green Paper.

The mortgage **funding priorities** should be

- **The formation of a working group to contribute to further work on mortgage funding efficiency.**
- **Exploring the strong potential of industry collaboration in this area.**
- **Liberalising those regimes that restrict mortgage lending to particular sorts of enterprise, such as those taking deposits.**

# **The Green Paper**

## **Context – the UK Mortgage Market**

With around 600 lenders and 12,000 intermediaries, and lending of upwards of £290bn last year via over 7,000 different mortgage products, the UK has one of the most diverse and complete mortgage markets in the EU. In providing our detailed response to the questions posed by the Commission in the Green paper we have drawn on the experience of both designing and implementing regulation for this market. That process involved comprehensive cost benefit analysis and consultation with all of those involved in the lending industry and consumers, and included major programmes of consumer testing.

## **Consumer Protection**

There is a major social and human dimension to mortgage credit. For most consumers, mortgages are the most significant financial decisions they undertake.

Mortgage markets are, however, likely to continue to operate through national distribution arrangements. Accordingly the policy emphasis should be on respecting existing national arrangements for consumer protection. Any reform would not only need to be fully informed by appropriate analysis and impact assessment, but must also be developed using full consumer testing.

## **The Code of Conduct and Information Provision**

The voluntary Code of Conduct is a positive example of an alternative to EU legislation and as such should be encouraged. The Code has been operational for a relatively short period of time and in the UK's opinion it should be given more time to become established and for its impacts to be assessed before any changes are proposed.

In the UK's view it is fundamental that information should be provided at a stage that enables consumers to shop around and compare mortgages. The principal objective should be to ensure that the consumer has the opportunity to consider the information before being asked to commit to a particular product. Consumer research is essential in order to establish the optimal balance between detail and quantity of information that best helps consumers compare offers.

Whilst the UK welcomes the Green Paper's recognition of a need for balance when providing information, it is important to recognise legislative standards for consumer information would involve significant costs for industry, which would be passed on to consumers. As there is no evidence that the absence of standardised product information is a primary barrier to integration, we do

not think that legislative intervention in this area is likely to be justified in cost benefit terms.

## **Advice**

In the UK's view advice should not be compulsory. In the first instance, not all consumers will require advice, so a mandatory advice regime would impose costs without discernable benefit, as the costs of providing compulsory advice would inevitably be passed on to consumers.

Furthermore compulsory provision of advice could significantly harm consumer willingness to shop around. Evidence points to consumers being very reluctant to undergo repeated advice meetings with lenders. Given this consumer trait, there is also a danger that mandatory advice would favour intermediated sales, where the number of advice meetings would be limited, at the expense of direct sales, thus distorting the mortgage market.

Nevertheless, consumers should be able to rely on advice that they receive. The standards of advice, disclosure of charges and other disclosures should continue to be matters of national contract and consumer protection law.

## **Annual Percentage Rate**

The purpose of APR disclosure is to provide consumers with both absolute and comparative cost information. It provides valuable information, for example illustrating the effect of charges on a stand-alone interest rate, but it also acts as a yardstick to enable cost comparison between similar products.

Existing EU legislation already provides a standard basis for the APR calculation. With many firms offering both consumer credit and mortgages, and consumers potentially comparing both, the calculation for mortgages and credit should be as similar as possible. The true cost of any credit deal, and therefore the basis for a proper comparison, is often dependent on facilities or services sold with the loan. This argues for the standardised calculation continuing to be broadly drawn in terms of the cost elements included.

## **Early Repayment Fees, Usury Rules and Interest Variation Caps**

In the UK's view arbitrary caps on early repayment fees or interest charges will inhibit the willingness of firms to offer particular products or lend to higher risk consumers and so restrict market completeness. They may also distort lending behaviour through encouraging cross subsidy within product offerings, leading to higher overall pricing for consumers.

Caps on compound interest rates may have a particularly detrimental affect on the development of equity release products across EU markets. In the UK a large number of these products rely on the compounding of interest, as there is no repayment of interest during the life of the loan.

The UK believes that ability to repay a loan early is an important component of market liquidity and we therefore support the right of consumers to have this facility, subject to an entitlement for business to recoup fair and reasonable costs associated with early repayment.

There should be clarity for both consumers and businesses as to how compensation will be calculated and paid. UK rules require disclosure of illustrative cash amounts relating to possible charges. Consumers should not merely be presented with an arithmetic formula from which costs might be calculated.

### **The 26th Regime**

The UK would not be opposed to further work in this area, however the creation of a 26th regime would require strong, evidence-based justification. It would also need to ensure that the principle of subsidiarity was fully respected as the substance of contract law is properly for the national law of member states.

### **Alternative Means of Redress**

In the first instance it should be the responsibility of firms themselves to treat consumer complaints fairly. Firms should resolve complaints themselves as far as possible, however separate national complaint schemes can serve a useful supplementary purpose by ensuring the quality of complaint handling is high.

In the UK the Financial Ombudsman Service provides a complaints arbitration service, which is free to consumers. Consumers who have complaints about the sale or administration of regulated mortgages have access to this scheme. We are aware that many other Member States also have effective redress arrangements, however as a first step there may be a role for the Commission in promoting the wider development of such schemes.

## **Legal Issues and Mortgage Collateral**

While these are two of the shorter sections of the Green Paper we believe they address the major areas where progress can be made to enhance market access by lenders.

The legal issues raised in the original Forum report were wide ranging. The Green Paper sets out views on the Rome Convention and applicable law, where the Commission should seek to avoid duplication of other work.

In common with our overall priorities, we believe the Commission should seek to find collaborative and non-regulatory measures that foster the development of a single market in this broad area. Accordingly we support the development of broader access to client credit worthiness and land register data. Ready access to this data underpins the operation of an efficient lending industry.

Our starting point is that business decisions on whether to enter new mortgage markets are invariably complex, and that no single issue is necessarily decisive. Nevertheless, firms are much more likely to enter markets where lending decisions are assisted by

- Access to consumer credit data.
- Trustworthy valuation standards.
- Confidence in repossession procedures.
- Access to land registration data, to demonstrate the extent and quality of the underlying security.

## **Credit Data Sharing**

In the UK's view, greater access to consumer credit data is an essential prerequisite for increased cross border supply of mortgage lending and thus of greater EU mortgage market integration. We would therefore suggest that the Commission prioritise further work in this area, however we recognise that there are important considerations about the form of data held and consumer privacy that would need to be respected.

The UK believes that non-discriminatory access to credit data should be achievable through cooperative, non-legislative measures. The focus of Commission work should, in our view, be to address barriers to market entry created by discriminatory access to credit data. A useful first step for the Commission would be to take forward work to map credit data access across the EU and identify where specific issues exist.

## **Valuation**

The UK believes that non-legislative methods may also be relevant to enhancing trust in valuation standards. The options appear to be to ensure greater understanding of national valuation standards or migration towards a single standard. A single valuation standard holds some attractions for both providers and users of valuation services. The way forward is to undertake work amongst industry practitioners and professional users to explore the scope to build on existing industry standards.

A good deal of work has already been done in this area, and the Commission should align any work in this area with proposals already developed by European and International professional bodies.

## **Forced Sales**

The UK supports the Commission's proposed gradual approach in the area of forced sales procedures. Careful consideration must be given to understanding national procedures, and to ensuring that the data published is genuinely useful and comparable. Careful attention must also be paid to avoiding new regulatory burdens, and ensuring that any measures proposed in this area are subject to cost benefit analysis.

## **Land Registers and EULIS**

The UK believes that clarity around land registration is another important prerequisite of more integrated markets in mortgage credit across the EU.

The approach used in the EULIS project appears to have been successful in delivering enhanced access to land registration information amongst participating Member States. EULIS accepts that national arrangements differ considerably, but provides access to, and explains, those arrangements. It functions as a portal to those countries that have electronic registers, including the UK, where all three registers belong to EULIS, and already allows worldwide access to registered land titles.

EULIS is looking to develop a user fee system to provide longer term funding. We also note that the central EULIS budget for shared costs in 2006 is €305,000. This clearly represents a wholly different order of costs compared to the multi-billion euro costs discussed in the London Economics study.

Given the success of this project to date and the efficiency with which it has begun to tackle barriers to cross border supply of mortgages, the UK would suggest that EULIS might serve as a useful for model or pilot for other non-legislative interventions to encourage greater mortgage market integration.

## **Funding**

The UK strongly supports further work on market led initiatives in the funding area. Improved efficiencies in EU mortgage funding markets should deliver consumer benefits both in terms of lower prices and product innovation. Equally important is the role that access to capital market funding has in lowering the barriers to market entry for lenders – clearly critical if EU mortgage markets are to become more competitive.

The UK mortgage market has benefited from the participation of institutions that are not deposit funded, and the availability of capital market funding has been important in facilitating mortgage lending to consumers with impaired credit histories. The UK therefore believes that subject to the minimum protections necessary to ensure the stability of the financial system and to safeguard the interests of consumers, there should be no restrictions on the categories of business able to offer mortgage credit.

The UK therefore supports the Commission proposal to set up an expert group to look more closely at the ways in which industry-to-industry transactions might be made more efficient by formal collaborative arrangements, such as the adoption of standard forms of contract and standard terms.

## The London Economics Study

The UK welcomes the general approach the Commission has taken to this dossier. We particularly support the Commission's commitment to carrying out a robust impact assessment of any proposed legislative measures and consider that the London Economics study is a useful first step. We believe that several issues would benefit from further careful study:

- Some of the differences between member states' mortgage markets result from structural differences in demographics, geography, social provision and culture. This suggests that there may be good reasons for the level of prices and product availability to be different between member states, which would not disappear with greater integration.
- The London Economics study does not adjust prices for product differences. Evidence from the Mercer Oliver Wyman study shows that the gaps in adjusted prices are even smaller than the ones reported by London Economics. So the estimate of benefits from price convergence, which is already small, will reduce further when adjusted for product differences.
- In estimating the future trend for the level of mortgage debt for each EU member state, the London Economics study does not take into account any price and/or interest rate adjustments that may result from short-term imbalances between demand and supply in the housing market that may lower or at least delay the benefits from integration.

As the Commission recognises, the London Economics study will need to be supplemented by a cost-benefit analysis (CBA) of any individual measures the Commission proposes. In the UK the FSA has considerable experience of undertaking such studies to support domestic regulatory interventions. As such we would offer the following thoughts on how such a cost-benefit analysis might be carried out:

- The decisions about which measures to put forward should be backed by a full market (integration) failure analysis. This will define the problem (if there is one). Knowing what the problem is will enable the Commission to design interventions that can improve how the markets work.
- The CBA of intervention needs to be based on a clear counterfactual – what would have happened if intervention had not taken place. For example, market forces might have delivered the benefits at the same time as intervention or not much later.
- CBA of each individual measure should examine the extent of the benefits, assessed in terms of the proposals' ability to overcome the barriers to integration and ultimately their ability to bring about integration and unlock the additional welfare that may result from it.

- The CBA should estimate the one-off and ongoing costs imposed on firms and consumers of implementing and complying with the proposals.
- The CBA should examine other market impacts, in terms of indirect benefits, indirect costs and unintended effects of the proposal.