European Economic and Social Committee

INT/400
Mortgage credit

Brussels, 9 July 2008

OPINION

of the

European Economic and Social Committee

on the

White paper on the integration of EU mortgage credit markets

COM(2007) 807 final

____

99 rue Belliard - B-1040 Brussels - Tel. +32 (0)2 546 90 11 - Fax +32 (0)2 513 48 93 - Internet http://www.eesc.europa.eu

EN

On 18 December 2007 the European Commission decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the:

White paper on the integration of EU mortgage credit markets
COM(2007) 807 final.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 11 June 2008. The rapporteur was Mr Grasso.

At its 446th plenary session, held on 9 and10 July (meeting of 9 July), the European Economic and Social Committee adopted the following opinion by 123 votes to one with five abstentions.

*

*   *

1. **Assessment and recommendations**

1.1 Once again the Commission has asked our Committee to draw up an opinion on the integration of mortgage credit markets for the purchase of residential and other buildings, i.e. on the White paper on the integration of EU mortgage credit markets.

1.2 Usually White Papers are the outcome of a quasi-definitive and structured policy analysis of "what to do". This is not the present case. Indeed, the Commission has to analyse many issues that are still uncertain, such as common investment funds, financial services providers, product tying, etc. In total, 14 aspects are considered.

1.3 As a result, the White Paper does not represent a completed process but, on the contrary, remains open due its effective and noticeable complexity. Why then has another opinion been requested, given that the White Paper adds nothing new to the Green Paper, and that the EESC has already adopted an opinion on the Green Paper?

1.4 This is an issue that, over the years, has been repeatedly tabled for discussion without the Commission finding a way forward and making a proper decision that overcomes the cultural, legal, administrative and other barriers, which the EESC considers to be the real obstacles to the Commission's objectives.

1.5 The EESC opinion on the Green Paper[1], adopted in plenary in December 2005 with only one abstention, remains entirely relevant.

---

1 OJ C 65 of 17.3.2006, rapporteur: Mr Burani.

1.6 The White Paper still paints a highly variegated picture of the sector due to the cultural, legal, legislative and socio-ethical specificities that purchasing property, and especially residential property, has in respective Member States.

1.7 Nevertheless, the EESC, albeit unsure about the real possibility of integrating and harmonising the EU mortgage credit market, which presents so many specificities and profoundly different characteristics (Burani opinion, 15.12.2005[2]), endorses in principle the Commission's attempt to establish "rules", whether optional codes of conduct (i.e. best practice) or binding.

1.8 Nevertheless, the measure may be considered as excessive if the intention is to reconsider the equally positive opportunities already inherent in the regulatory automatism of the mortgage credit market today.

1.9 In the meantime, the EESC recommends that the Commission should take steps to analyse in greater detail areas (e.g. credit registers, foreclosures, the dissemination of financial literacy) that do not present undue difficulty, always provided that this would be worthwhile.

1.10 The EESC believes that under the Commission's orientation, the measure still places **undue focus on the possible short-term benefits** of introducing new rules based on somewhat partial interpretative schemas of the mortgage credit market. A short-term approach serves to lower the cost of financing mortgages without, however, concerning itself with the effective benefit that EU citizens might derive from existing financial products and innovations affecting these products.

1.11 The EESC maintains (as also stated in the Burani opinion) that the framework proposed by the Commission is not properly aligned with continuous market developments; it is therefore concerned about the long-term consequences for more vulnerable contracting parties, i.e. those consumers most in need of protection.

1.12 The EESC welcomes the fact that a link has been established between the current mortgage credit rules and the need for consumer protection. These are laudable intentions worthy of encouragement provided that they are designed to foster greater financial literacy on the subject of mortgage credit. The Commission's intention to **take steps to strengthen transparency rules** in order to enhance consumer protection is therefore to be commended.

1.13 However, at the same time, **imposing, at all costs, general rules for assessing the risk** presented by prospective borrowers may prove to be a difficult and uncertain undertaking.

2 OJ C 65 of 17.3.2006, p. 113, rapporteur: Mr Burani.

1.14 The EESC believes that consumers must be protected during mortgage negotiations but that borrowers must not lose sight of their responsibilities vis-à-vis the lender.

2. Gist of the Commission document

2.1 On 18 December 2007, the impact assessment {SEC(2007) 1683} accompanying the White Paper on the Integration of EU Mortgage Credit Markets was published. Three annexes were appended to the document: i) mortgage market characteristics ii) process iii) impact assessment on specific issues.

2.2 Although {SEC(2007) 1684} constitutes an excellent summary of the documents, in the interest of brevity, there are a few key points worth emphasising in the document in respect of which a new EESC opinion has been requested:

- a **highly fragmented picture** is painted due to the cultural and legislative specificities and – above all - the socio-ethical value that home ownership has in respective Member States;
- all the **sensitive aspects of the issue**, including economic and financial considerations, are reaffirmed, given the real estate market's importance for EU economies, not to mention the contribution that mortgage investments make to the banking sector's profitability; and
- emphasis is placed on how in the current fragmented situation, use could also be made of **a new legislative proposal** to promote greater market integration.

2.3 Thus, the Commission document takes up the points already studied in the earlier Green Paper on mortgage credit. It could not have been otherwise since the new document is about the integration of EU mortgage credit markets and the relevant impact assessments previously mentioned.

2.4 Nevertheless, the EESC adopted an opinion on the Green Paper on 15 December 2005 (rapporteur: Mr Burani), and to all intents and purposes, the EESC's position on the subject is set out in that opinion. In this opinion, the EESC will focus on two new points raised by the Commission:

- giving its own opinion on the intended measures proposed by the Commission in the light of impact assessments carried out in relation to the White Paper[3]; and
- drafting proposals, as requested by the Commission when it concludes that "a comprehensive monitoring and evaluation programme can only be developed once detailed proposals have been made"[4].

---

3 See Annex II of the White Paper, the disclaimer on page 5 of the EN version.

4 See Annex II of the White Paper, point 8.

3. EESC comments on the White Paper

3.1 The White Paper raises numerous issues to be solved, on which the EESC has been asked to give an opinion. These can be brought under eleven thematic headings:

1) choice of required product;
2) early repayment;
3) product mixes;
4) credit registers;
5) real estate valuations;
6) real estate enforcement measures/forced sales procedures;
7) national registers;
8) applicable law;
9) rules on variations in interest rates, and so-called usurious interest rates;
10) mortgage credit financing;
11) non-banking and service institutions.

3.2 Comments on specific points in the impact assessment

3.2.1 ***Pre-contractual information.*** In order to reduce information imbalances during the pre-contractual stage, the EESC considers it important to circulate and disseminate information and raise awareness on specific mortgage credit issues. This should not incur further costs for citizens.

3.2.1.1 Increasing information and disseminating financial literacy are prerequisites for the efficient assessment of the cost-benefit ratio of a risk situation. Indeed, the best way to prevent contracting parties from assuming undue risk is to provide them with effective knowledge of these very risks.

3.2.1.2 The EESC believes that it is important to stress that the rules and binding provisions should cover **methods for circulating information** and provision of possible penalties for breaching them. Nevertheless, the EESC believes that imposing a *sic et simpliciter* obligation on one contracting party would merely have the effect of inciting that party to try to offset this obligation by shifting the burden onto the other party.

3.2.2 ***Codes of conduct.*** The EESC believes that incentives should be created to encourage adherence to the voluntary code of conduct.

3.2.2.1 This would give borrowers a clearer understanding of the risk they may be undertaking, and of their chances of obtaining favourable financing conditions.

3.2.2.2 The measure that springs to mind could involve making it compulsory for borrowers to answer a list of standard **self-assessment queries on their medium to long term ability to meet the financial commitment**.

3.2.3 ***Cost rate*.** The EESC believes that it is appropriate for lending institutions to disclose the total cost of the loan and provide a cost breakdown of its various components, including the fiscal variable**.**

3.2.4 *Consultancy*. The EESC believes that consultancy services strictly linked to mortgage credit should be enhanced via independent pricing mechanisms, albeit set out in the calculation of the total cost of the transaction.

3.2.5 **Early repayment**

3.2.5.1 ***Applicability*.** With regard to the issue of early repayment, a distinction should be made between (i) total or partial early repayment of the mortgage and (ii) early terminations relating to opportunities for negotiating more favourable conditions of cost with other financial institutions.

- In the first case, the EESC considers it important always to allow early repayment, including early partial repayment.
- In the second case, however, it considers that the loan contract should be transferred to another financial institution.

3.2.5.2 ***Cost*.** With regard to the issue of early repayment, the EESC believes that costs should be calculated according to the appropriate mathematical formulae and must, under law, be spelt out in contractual relations. **Costs should only be charged to the client in case of voluntary repayment of the credit. In case of contract termination, costs should be charged to the successor financial institution.**

3.2.6 ***Product tying*.** In order to be valid, product tying should depend above all on the ability to demonstrate the effective utility of tying the product. The EESC believes that this issue could be solved by obliging lenders to present cost-benefit calculations and giving borrowers a reasonable period of time to decide whether to accept the proposal, possibly even after the loan contract has been signed.

3.2.7 ***Credit registers*.** The EESC agrees on the need for a pan-European register, access to which would be regulated by specific privacy laws. Indeed, the EESC believes that setting up a pan-European credit register could also serve to heighten competition between mortgage lenders across Europe. In any case, cross-border access to the registers of all Member States should be facilitated by simplifying information procedures.

3.2.8 ***Property valuation.*** The basic premise is that property valuation is more complex than generic financial valuation. Indeed the specific nature of real property (notably, that it is immovable) determines its usefulness, and moreover, other external factors relating to its location influence its valuation. These factors include:

- morphology,
- transport services,
- population density, etc.

For this reason, it is pure idealism to believe that all these valuation factors can be summed up in a single formula.

3.2.8.1 ***Criteria for property valuations***. The EESC therefore emphasises the complexity involved in real estate valuations arising from the abovementioned factors and does not consider it useful to define a specific blanket formula for property valuations. A better alternative would be to **develop local best practice** and strengthen the obligation for valuations to be carried out by operators accredited by the competent professional associations in their sector, who would also assume responsibility for the fairness of a given proposal.

3.2.8.2 ***Property risk valuations.*** The EESC is also of the opinion that property valuation should be accompanied by a volatility assessment vis-à-vis the identified value, in order to provide a more accurate evaluation of the guarantee offered by the property. The EESC also recommends applying instruments already in use by financial market operators and, for the most part, already established under other EU provisions such as, for instance, value-at-risk[5].

3.2.9 ***Foreclosures***. If mortgage credit is split into an asset-backed loan and a personal loan, then we also need to distinguish between the financial beneficiary of the property and the owner providing formal guarantees.

3.2.10 ***Applicable law***. The EESC believes that opportunities for profitable arbitrage between the different advantages offered by the civil and fiscal laws of individual EU countries would serve as a driver for otherwise unachievable market integration.

3.2.10.1 For this reason, the EESC is broadly in favour of leaving existing Member State legislation unchanged and allowing contracting parties to choose the one that cuts the loan transaction's overall costs, as already set out in the Rome Convention[6].

---

5 See the Markets in Financial Instruments Directive (MiFID), i.e. Directive 2004/39/EC, which was adopted on 21 April 2004, and which was published in the Official Journal and came into force on 30 April 2004.

6 See COM(2005) 650 of 15 December 2005.

3.2.11 ***Usurious interest rates.*** The EESC reiterates its previously expressed views on this issue, especially with regard to the extreme difficulty involved in defining a usurious level of interest correctly by applying a regulatory framework set up for consumer credit. Nevertheless, it should be stressed that information remains the best defence against usury. The EESC therefore advocates setting up communication instruments on a vast scale to provide information about the risk premium bands applied to different categories of borrower risk.

3.2.12 ***Refinancing mortgage credit.*** The EESC believes that the White Paper's approach, which seeks to differentiate between refinancing rules on the basis of the subjective nature of the intermediaries (distinguishing between banking and non-banking institutions) is far too easy to circumvent.

3.2.12.1 ***Non-banking and service institutions.*** Mortgage lending should always be carried out by regulated and monitored banking institutions. Promotion and support from intermediaries (e.g. consultancies) are acceptable if provided by qualified institutions even if they are non-credit institutions.

4. EESC proposals to be developed

4.1 The recent sub-prime mortgage crisis in the United States has revealed how the volatility of property prices combined with poor client-risk assessment practices with respect to non-payment of instalments that are out of proportion with the actual value of the mortgaged property itself, can generate a financial crisis serious enough to destabilise the entire system. For this reason, any EU action should draw on this experience as well as on the comments made under the previous point.

4.2 Introducing a twenty-eighth system for regulating mortgage credit to complement the ones that already exist in EU Member States, as suggested in the White Paper, could contribute to the integration of the EU mortgage credit market by increasing choice for the contracting parties without, however, creating the conditions for destabilising the financial system revealed by the sub-prime mortgage crisis.

4.3 It is common for real estate purchase choices, especially where homes are concerned, to be influenced in part by emotional (i.e. subjective) factors that have nothing to do with a proper and rational assessment of a property's value (i.e. objective factors). Thus, the effectiveness of any measures proposed by the Commission on mortgage credit cannot be separated from the reference context (objective as well as subjective).

4.4 It would therefore be interesting to develop a proposal, which the EESC could analyse further, and which would consist in adopting an interpretative schema for mortgage credit that subdivides each loan transaction into a portfolio of two passive components:

- firstly, an asset-backed loan, the value of which is based on the market price and possible property value fluctuations; and
- secondly, a prospective loan (personal loan), the value of which is based on the borrower's economic/financial capacity and prospects.

4.5 Adopting a twin-mortgage system could have a number of advantages to be verified during further analysis, including:

- simplifying the risk assessment of the rational aspect of the transaction (asset-backed loan) vis-à-vis the risks associated with the mortgagee's solvency (prospective personal loan);
- the possibility of establishing transparent prices that reflect the various risk levels represented by the two components of the loan transaction (objective asset-backed loan and subjective personal loan); and
- reducing the adverse impact on the financial system in the event of mortgage defaults by an excessive number of borrowers, contrary to the impact recently experienced by the financial market (i.e. the sub-prime mortgage credit crisis).

4.6 The EESC hopes that the Commission will bring this process to a conclusion as soon as possible, showing greater determination and creating conditions whereby the separation of the institutional aspects could be the basis for launching a twenty-eighth system.

Brussels, 9 July 2008.

The President of the European Economic and Social Committee	The Secretary-General of the European Economic and Social Committee
Dimitris Dimitriadis	Patrick Venturini