COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.12.2007
COM(2007) 807 final

WHITE PAPER

on the Integration of EU Mortgage Credit Markets

(presented by the Commission)

{SEC(2007) 1683}
{SEC(2007) 1684}

WHITE PAPER

on the Integration of EU Mortgage Credit Markets

(Text with EEA relevance)

1. INTRODUCTION

Mortgage credit is, for most European citizens, the biggest financial investment of a lifetime. Mortgage credit markets represent a significant part of Europe's economy, with outstanding residential mortgage credit balances representing almost 47% of the EU GDP[1]. Accordingly, the integration of EU mortgage credit markets is central to a more efficient functioning of the EU financial system both at the wholesale and the retail level as well as the EU economy as a whole.

Aware of the crucial importance of mortgage credit markets, the Commission initiated a comprehensive review of the functioning and the level of integration of these markets. This White Paper summarises the conclusions of this review and presents a balanced 'package' of measures to improve the efficiency and the competitiveness of EU residential mortgage markets[2]. In full compliance with the principles of better regulation, these measures have been designed after thorough consultation with all stakeholders and on the basis of a proportionate impact assessment[3].

The Commission has also duly taken into account, where possible and appropriate, the lessons that can already be drawn from the recent events in financial markets. However, this White Paper is not as such a response to the current financial turmoil that originated from problems in the US sub-prime market. This turmoil has wider implications, which have been more comprehensively addressed by the ECOFIN Council at its meeting of 9 October 2007.

The policy orientations presented in the White Paper will be further developed in close cooperation with all stakeholders. They will be subject to individual impact assessments, including a quantitative cost-benefit analysis, before their adoption by the Commission.

This White Paper shall be placed in the context of the Commission Communication on a Single Market for 21st Century Europe[4], which underlined the benefits that the European economy could derive from a greater integration of retail financial services markets.

2. EU CASE FOR ACTION

The Treaty provides the basis for the creation of a single market and the abolition of obstacles to the free movement of goods, persons, services and capital. Evidence however shows that the single market for residential mortgages is far from integrated. Obstacles exist that restrict the level of cross-border activity on the supply and demand sides, thus reducing competition and choice in the market.

---

1 *HYPOSTAT 2005: A review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2006, p. 140.

2 The review covers loans secured by a mortgage or by another comparable surety as well as loans to purchase property.

3 See Impact Assessment for further information.

4 COM(2007) 724, 20.11.2007 and SEC(2007) 1520, 20.11.2007. See also COM(2005) 629, 1.12.2005; COM(2007) 33, 31.1.2007 and SEC(2007) 106, 31.1.2007; and COM(2007) 226, 30.4.2007.

One study estimates the potential economic benefits from integrating EU mortgage markets as 0.7% of EU GDP and 0.5% of private consumption over the next ten years[5]. The study suggests that these benefits could lower mortgage interest rates by up to 47 basis points by 2015, thereby reducing the interest payable on a EUR 100 000 mortgage loan by EUR 470 per year[6]. Another study puts the benefits at 0.12–0.24% of EU GDP per annum[7]. The estimated benefits, which could be slightly different today given the evolution of market conditions, arise from the increased efficiency of mortgage lenders and the availability of a wider range of products.

Limits to the potential for integration should however be acknowledged. The influence of factors such as language, distance, consumer preferences, or lender business strategies cannot be underestimated. However, other factors, which prevent the conduct of business or substantially raise the cost of business for offering or taking out a mortgage credit in another EU Member State, can be addressed by appropriate policy initiatives.

The Commission recognises that consumers predominantly shop locally for mortgage credit and that the majority will probably continue to do so for the foreseeable future. The integration of EU mortgage markets will therefore be essentially supply-driven, in particular through various forms of establishment in the Member State of the consumer.

3. OBJECTIVES

Competitive and efficient EU mortgage credit markets can be achieved by measures which facilitate the cross-border supply and funding of mortgage credit, increase the diversity of products, improve consumer confidence and promote customer mobility.

3.1. Facilitating the cross-border supply and funding of mortgage credit

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

The existence of differing legal and consumer protection frameworks, of fragmented infrastructures (e.g. credit registers), as well as the lack of appropriate legal frameworks in some instances (e.g. for mortgage funding), create legal and economic barriers, which restrict cross-border lending and prevent the development of cost-efficient, pan-EU funding strategies. The Commission therefore seeks to remove disproportionate obstacles, thus reducing the costs of selling mortgage products across the EU.

The Commission believes that the different mortgage funding instruments are complementary rather than substitutable. The aim should be to facilitate, and not restrict, the development of a wide range of mortgage funding instruments. The use of funding techniques that transfer the risk of mortgage loans away from the originating mortgage lenders to the capital markets provides benefits in terms of risk diversification and funding costs. However, recent experiences have highlighted the need to ensure that such techniques are used in a way that is not detrimental to financial stability.

5 *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 5.

6 Cf. footnote 5, p. 5.

7 *Study on the Financial Integration of European Mortgage Markets*, Mercer Oliver Wyman and the European Mortgage Federation, October 2003, p. 77–78.

3.2. Increasing product diversity

Although a wide range of products is available across the EU, no single domestic market can be considered as having a complete range of mortgage products, in terms of either product characteristics or borrowers served. This is due, to some extent, to factors such as consumer preferences or different business strategies adopted by mortgage lenders. However, economic and legal barriers also exist which prevent mortgage lenders from offering certain products in certain markets or opting for a given funding strategy. In this respect, barriers to product diversity are closely related to the other barriers inhibiting cross-border activity by mortgage lenders.

An increase in product diversity has been identified by a number of studies as the crucial element for achieving most of the benefits of mortgage market integration. One study estimates that removing the barriers to product availability alone would increase EU consumption by 0.4% and EU GDP by 0.6% over the next ten years (compared to an estimated overall increase in EU consumption by 0.5% and in EU GDP by 0.7%)[8]. Another study suggests that improved product diversity would lead to a 10% expansion in the market size by enabling new borrowers to access mortgage credit, and a quarter of existing borrowers to find more suitable products, bringing annual benefits of between 0.15% and 0.30% of residential mortgage balances, equivalent to 0.06–0.12% of GDP in 2003[9].

The Commission seeks to increase the diversity of products that could meet consumers' needs, by removing barriers to the distribution and sale of products, particularly new and innovative mortgage products. The Commission recognises the fact that many of the rules which restrict the offering of certain products on a cross-border basis have been designed to protect consumers and/or preserve financial stability. The problems which occurred recently on the US sub-prime market serve as useful reminders of the importance of not taking undue risks with these crucial public policy objectives. The Commission wishes nevertheless to explore ways through which greater product diversity can be combined with strong consumer protection and adequate financial stability.

3.3. Improving consumer confidence

Taking out a mortgage credit is an important decision for any consumer. The Commission believes that there can be no efficient market without confident and empowered consumers, who are able to seek out and choose the best mortgage product for their needs, regardless of the location of the mortgage lender. In order to make an appropriate choice, consumers require clear, correct, complete and comparable information on different mortgage products.

The Commission considers it essential that mortgage lenders lend responsibly, in particular by thoroughly assessing the borrowers' ability to pay instalments in the context of the transaction envisaged. They can do such an assessment in a variety of ways, for example by consulting a database. Irresponsible lending and mis-selling of mortgage loans by mortgage lenders or unscrupulous credit intermediaries can, as illustrated by the current sub-prime turmoil, have a negative impact on the economy at large.

Good advice, including legal advice, is an important element in enhancing consumer confidence. It is distinct from information, which is merely a description of the product. The Commission wishes to promote high-level mortgage advice standards, whilst recognising that not all consumers need the same level of advice.

---

8 Cf. footnote 5, p. 6.

9 Cf. footnote 7, p. 78.

3.4. Facilitating customer mobility

Customer mobility and the propensity of consumers to switch mortgage lenders can influence the level of competition in the market. The Commission wishes to facilitate customer mobility by ensuring that consumers seeking to change mortgage lenders are not prevented or dissuaded from doing so by the presence of unjustifiable legal or economic barriers.

Price transparency, through the provision of clear and comparable information, has an important role to play in facilitating customer mobility. Initiatives to improve the quality and clarity of pre-contractual information are therefore vital to ensure that consumers are fully aware of all the different costs and product characteristics. Information alone cannot, however, facilitate customer mobility. By increasing switching costs, 'tying' practices (e.g. obliging the consumer to open a current account or take out an insurance policy with the same company when purchasing a mortgage credit) effectively bind consumers to a particular financial services provider, thus restricting mobility and weakening competition. Practices such as obliging consumers to transfer their salary to the current account attached to the mortgage credit may have a similar effect. These practices not only have implications for customer mobility but can also reduce price and product competition in the markets for the tied and tying products and discourage the entry of new players, particular those providers specialising in the tied product.

4. ACHIEVING THE OBJECTIVES

The Commission believes that to achieve these objectives further work is needed to deliver the most appropriate policy-mix.

4.1. Assessing the need for legislation

On the basis of its review, the Commission believes that the following elements are the key issues to be addressed: pre-contractual information; Annual Percentage Rate of Charge (APRC); responsible lending and early repayment.

While the general impact assessment accompanying this White Paper suggests that legislation would be for some areas the most effective policy option to achieve the set objectives, the Commission is of the view that further analysis and consultation with stakeholders must take place before a final political assessment can be made on the most appropriate way forward.

In particular, in line with its better regulation principles, the Commission will undertake a rigorous impact assessment, including a quantitative cost-benefit analysis of various policy options for all issues, in order to ensure that costs do not outweigh the expected benefits. Until this detailed work has been undertaken and further consultation with stakeholders have been concluded, the Commission considers that it would be premature to decide on whether a Directive would deliver the necessary value added.

Early repayment

The Commission views early repayment as one of the most important issues for integrating EU mortgage markets. The impact assessment underlines the consequences of early repayment terms and conditions for all four Commission objectives. It also highlights the importance of early repayment for product diversity, which is identified by studies as one of the crucial elements for bringing the benefits of mortgage credit integration. In this context, the Commission believes that successfully addressing the issue of early repayment, in full awareness of the diversity of early repayment regimes across Member States, would enable the full benefits of an integrated European mortgage markets to be reaped. The Commission acknowledges the political sensitivity of this issue, and the complexity of finding an appropriate level of harmonisation (as shown by the difficulties encountered in the field of consumer credit). It believes, however, that it shares, together with Member States and the European Parliament, a responsibility to do all it can to allow European households to benefit from a wider range of contractual deals when taking out mortgage loans. The Commission is therefore determined to explore, in particular with Member States and the European Parliament, to what extent it would be possible to reach a consensus on an adequate European regime for early repayment.

In 2008, the Commission will:

– immediately explore possible policy options for early repayment;

– assess the costs and benefits of different policy options for early repayment (status quo, contractual option or mandatory right, level of compensation etc.).

Improving the quality and comparability of information

Preliminary results of consumer testing undertaken by the Commission show that it is very important for consumers to obtain pre-contractual information in a structured form allowing for comparison between offers. These results indicate that information should be comprehensive, include tables and concrete examples and employ simple wording with a limited use of technical jargon. Such information should be provided sufficiently before the conclusion of the contract.

In spite of the important role that the Code of Conduct on Home Loans[10] (the Code) has played, the level and quality of information currently provided to consumers on mortgage credit still varies between Member States. The Commission considers that the Code is, on the one hand, somewhat outdated and, on the other hand, has not been a fully adequate substitute for binding rules. Adherence to the Code is not optimal[11] and it lacks effective monitoring and enforcement mechanisms, affecting its credibility with consumers. In addition, divergences in its application in different countries, such as when the European Standardised Information Sheet must be handed to the consumer, have created difficulties[12].

The APRC is a critical element of the information provided to consumers. The existence of different calculation methods and cost bases may limit the true comparability of different products, in particular on a cross-border basis, and thus mislead consumers. Harmonisation of the APRC is essential to ensure high quality information standards and true comparability of different mortgage products for consumers.

In 2008, the Commission will:

– finalise a revised European Standardised Information Sheet (ESIS) on Home Loans, using to the largest extent possible the positive results[13] achieved by the Expert Group composed of lenders and borrowers that the Commission convened in 2006, and building on the initial results of consumer testing undertaken by the Commission in 2007;

---

[10] *European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans*, 5.3.2001.

[11] See for example: *European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans: Second Progress Report on Implementation in the European Union*, European Banking Industry Committee, 13.12.2005, which confirmed that although adherence and implementation of the Code in some markets was close to 100%, in other markets the situation was less satisfactory, and *Monitoring the Update and Effectiveness of the Voluntary Code of Conduct on Pre-Contractual Information for Home Loans*, Institute for Financial Services, 17.6.2003.

[12] *Mortgage Industry and Consumer Dialogue Final Report*, 20.12.2006.

[13] Notably, in terms of risk warnings and foreign currency loans.

- test more broadly this revised ESIS with consumers in all Member States;
- examine to what extent the provisions on APRC contained in the proposed Consumer Credit Directive could be extended to mortgage credit either as they are or in a way which takes into account the specificities of mortgage credit;
- assess the cost and benefits of the different policy options.

Promoting responsible lending and borrowing

The Commission believes that – for the benefit of all stakeholders (consumers, investors, lender's shareholders, etc.) – mortgage lenders and intermediaries should be required to adequately assess, by all appropriate means, borrowers' creditworthiness before granting them a mortgage loan. It should be also ensured that mortgage lenders are not discriminated against when accessing credit registers cross-border and that credit data circulates smoothly, while complying fully with EU data protection rules.

The Commission considers that mortgage lenders should provide full information and adequate explanations to the consumer, so that the latter makes a well informed choice, but should not be legally compelled to provide advice. Making the giving of advice compulsory may have a negative impact on mortgage prices and limit the range of products that consumers choose from, as mortgage lenders would naturally provide advice on their own range of products. Advice should rather be provided, at the consumer's request, by independent advisors or by the lender. However, when advice is provided, it should be in accordance with high level principles. In this context, it is essential that consumers can access objective advice, which is based on their individual profile and commensurate with the complexity of the products and risks involved. It is also essential that consumers provide full and accurate information to the advisor.

In 2008, the Commission will:

- consult with all stakeholders about the design of high-level advice standards;
- examine to what extent the provisions on non-discriminatory cross-border access to credit registers and the duty to explain contained in the proposed Consumer Credit Directive could be extended to mortgage credit;
- explore means of further increasing responsible lending, drawing on lessons from the US sub-prime crisis;
- assess the cost and benefits of the different policy options.

In order to assist the Commission in the preparation of adequate measures improving the accessibility, comparability and completeness of credit data, an **Expert Group on Credit Histories** will be created in 2008.

Improving consumers' financial literacy can also help them to assess the best products and services for their individual needs. The **Communication on Financial Education** published alongside this White Paper sets out the Commission's support for the provision of high-quality financial education across the EU.

The Commission believes that all issues of applicable law related to the mortgage contract should be addressed within the "Rome I" Regulation, recently agreed by the Council and the European Parliament. On the law applicable to the mortgage collateral, the Commission sees no reason to depart from the well established principle that the law of the country in which the property is situated applies.

4.2. Valuation, land registers and foreclosure procedures

The Commission considers that Member States should improve the efficiency of their forced sales and land registration procedures. These factors raise the cost of doing business for mortgage lenders, increase the uncertainty for investors about the quality of the underlying security and elevate refinancing costs, reducing the efficiency of existing providers and deterring new market entrants.

The Commission will publish regularly updated **'scoreboards'**, presenting objective information on the cost and duration of land registration and foreclosure procedures in all Member States.

In 2008, the Commission, subject to an appropriate impact assessment, will present a **Recommendation**. This Recommendation would in particular:

– invite Member States to ensure that their foreclosure procedures are completed within a reasonable time and at a reasonable cost, and that their land registers are available online;

– encourage Member States to adhere to the EULIS[14] project which has been sponsored by the Commission's eContent programme;

– invite Member States to introduce more transparency and reliability into their land registers, in particular with regard to hidden charges;

– invite Member States to facilitate the use of foreign valuation reports, and promote the development and use of reliable valuation standards.

4.3. Infringement policy

The Commission will continue applying a robust infringement policy. In particular, in 2008, the Commission will investigate whether:

– some of the national rules which create obstacles to the circulation of credit data, or prevent credit bureaux from providing services, constitute an infringement of the Treaty without prejudice to EU data protection rules;

– the prohibition of including non-domestic EU mortgage loans in cover pools for covered bonds, which currently exists in some Member States, is compatible with the free movement of capital and the freedom to provide services.

4.4. Follow-up of the Mortgage Funding Expert Group

Given the scope for enhancing the efficiency of EU mortgage funding markets, the Commission plans to continue its analysis of the nature, the causes and the magnitude of the problems identified by both the Mortgage Funding Expert Group[15] and the European Financial Markets Lawyers Group's Working Group on Securitisation[16]. While doing so, the Commission will take into account recent developments in sub-prime markets, the complexity and the horizontal dimension of the obstacles identified, as well as the wide-ranging implications for all stakeholders.

---

14 European Land Information Service (EULIS), which currently has ten participants, aims to provide easy cross-border access to information about ownership and interests in land and property via the Internet (www.eulis.org).

15 *Report of the Mortgage Funding Expert Group*, 22.12.2006.

16 *Legal Obstacles to cross-border securitisation in the EU*, European Financial Markets Lawyers Group, Working Group on Securitisation, 7.5.2007.

In particular, the Commission will examine:

– market practices and prudential standards for the management of liquidity mis-match risk, arising for instance from using short term funding for long term mortgage loans, in particular with regard to the ability to withstand stressed market conditions;

– mortgage lenders incentives to move risk off balance sheet;

– prudential standards and the transparency of banks' exposures to securitisation transactions that are directly or indirectly related to mortgage credit;

– whether further measures to improve transparency from the end investors' perspective are necessary.

The Commission expects the market to bring appropriate and rapid responses to the issues raised by the Economic and Financial Affairs Council on 9 October 2007, in particular on the issues of transparency and valuation of complex financial instruments.

Depending on future developments in financial markets, the creation of an **Expert Group on Securitisation** could be envisaged, with a view to developing an appropriate horizontal policy response to the complex challenges of securitisation.

4.5. Further research

As announced in the Green Paper on Retail Financial Services[17], the Commission is currently:

– reviewing the role and regulation of **non-credit institutions** in EU mortgage markets to assess whether appropriate action at Community level is needed. A study will be undertaken and the results will be available in 2008. The Commission is, in principle, in favour of allowing non-credit institutions to be active in the mortgage lending business, but deems it essential that responsible lending, financial stability and effective supervision are not in any way compromised.

– reviewing the national regulatory frameworks under which **equity release** products are marketed, in order to assess whether action at Community level is justified. A study of equity release schemes will also be undertaken and the results will be available in 2008. While acknowledging the potential economic role of equity release products (such as 'reverse mortgages'), the Commission is also aware that there are potential risks connected with equity release products.

In its Communication on a Single Market for 21st Century Europe released in November 2007[18], the Commission announced its intention to investigate **tying and other unfair practices** for credit, accounts, payments and insurance, in order to measure their impact on mobility. The Commission's objective is to develop a horizontal initiative on unfair commercial practices in the field of retail financial services, including mortgage credit.

Interest rate restrictions (e.g. anti-usury rules, interest variation limits, prohibition of compound interest etc.) which are in place in some Member States, may prevent the cross-border circulation of some products. Their implications on diversity and cross-border business must be carefully weighted against the fact that they may fulfil an important social and consumer protection role, and are in place in a limited number of Member States. Against this background, the Commission will publish a horizontal study in 2010, evaluating the impact of these rules on the Single Market, in the light of their objectives.

---

17 COM(2007) 226, 30.4.2007.

18 COM(2007) 724, 20.11.2007, and SEC(2007) 1520, 20.11.2007.

5. CONCLUSIONS

This White Paper has identified a package of proportionate measures designed to enhance the competitiveness and efficiency of EU mortgage markets which will benefit consumers, mortgage lenders and investors alike. Given the importance of mortgage credit for both EU citizens and the economy at large, an evidence based approach has been adopted. While recent events in global mortgage markets have confirmed the pertinence of the approach proposed, they have also identified areas where further work needs to be undertaken. The Commission intends to engage quickly with all stakeholders to complete its assessment of the various policy options.

To be effective, any proposed measures must demonstrate that they will create new opportunities for mortgage lenders to access other markets and engage in cross-border activity. They should also be shown to enable a more efficient mortgage lending process, with economies of scale and scope, which should lower costs. The expected benefits should be balanced against the possible costs of these measures.

The work carried out so far suggests that significant benefits can be expected from further action in several of the areas identified in this White Paper. Many of the measures designed to improve the efficiency and competitiveness of cross-border mortgage lending – both on primary and secondary markets – would also lead to improved product diversity and, potentially, lower prices for consumers. The White Paper identified the importance of good information, responsible lending and borrowing, and high quality advice for consumers in ensuring they purchase the best product for their needs. Consumers should also be the beneficiaries of efforts to improve customer mobility through increased transparency and reduced product tying.

In general terms, investors would face a lower risk when investing in mortgage backed products through enhanced market transparency, greater certainty as to the recovery value of their investment, and a broader range of investment opportunities as a result of enhanced product diversity both on primary and secondary markets.

ANNEX

Main tasks or activities announced in the White Paper

To be delivered by	Actions
2008	Preparation of an impact assessment on early repayment, pre-contractual information, Annual Percentage Rate of Charge, access to credit registers, assessing creditworthiness and advice standards and consultations with key stakeholders on the issue of early repayment
2008	Consumer testing of revised European Standardised Information Sheet
2008	Establishment of an Expert Group on Credit Histories
2008	Publication of study on the role and regulation of non-credit institutions in EU mortgage markets
2008	Publication of study on equity release
2008	Possible establishment of an Expert Group on Securitisation
2008	Look into the exclusion of non-domestic EU mortgage loans in cover pools for covered bonds and other aspects of the functioning of mortgage markets from the viewpoint of the free movement of capital guaranteed under the EC Treaty
2008	Publication of a study to investigate tying and other unfair practices for credit, accounts, payments and insurance
2008	Presentation of a Recommendation on land registration, foreclosure and property valuation
2008-2009	Publication of scoreboards on the cost and duration of land registration and foreclosure procedures
2010	Publication of a study evaluating the need for and the justification of interest rate restrictions (e.g. anti-usury, interest variation and compound interest rules) vis-à-vis their impact on the Single Market