027449/EU XXIII.GP
Eingelangt am 18/12/07

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.12.2007
SEC(2007) 1683
ANNEX I

COMMISSION STAFF WORKING DOCUMENT

Accompanying the

White Paper on the Integration of EU Mortgage Credit Markets

IMPACT ASSESSMENT

ANNEX 1: Mortgage market characteristics

{COM(2007) 807 final}
{SEC(2007) 1684}

TABLE OF CONTENTS

ANNEX 1: Mortgage market characteristics

Disclaimer
This impact assessment report commits only the Commission's services involved in its preparation and the text is prepared as a basis for comment and does not prejudge the final form of any decision to be taken by the Commission.

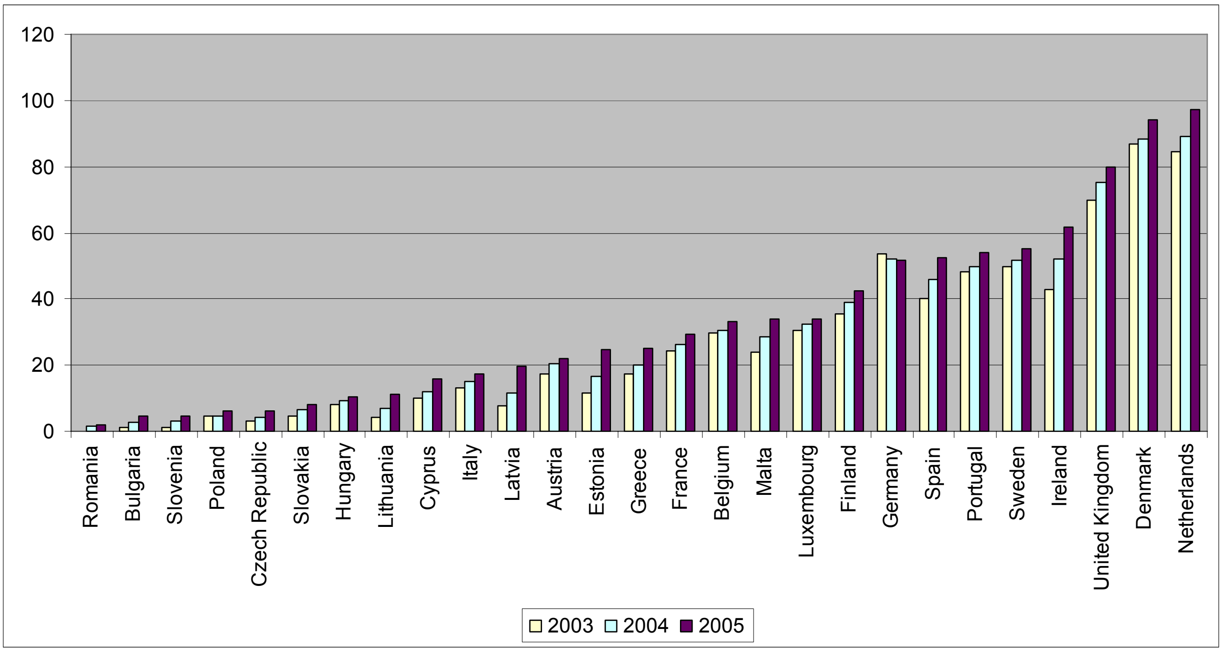
1. MORTGAGE MARKET CHARACTERISTICS

EU mortgage credit markets represent an important element of the economy in all EU Member States. As of 2005, there were EUR 5.1 trillion residential mortgage loans outstanding in the EU, representing 47% of EU GDP[1]. The size of national mortgage markets however varies considerably ranging from EUR 1.4 trillion in the UK and EUR 1.2 trillion in Germany to EUR 1.3 billion in Slovenia and EUR 1 billion in Bulgaria[2].

Mortgage debt as a percentage of GDP also varies considerably, with mortgage debt representing 97% and 94% of GDP in the Netherlands and Denmark respectively to 5% and 6% of GDP in Slovenia and Poland[3]. Mortgage debt to GDP ratios have however risen steadily across almost all EU countries in recent years reflecting the higher value of household assets as well as rising numbers of mortgage borrowers. This can be attributed to a range of different factors including increasing residential investment, higher income expectations, falling interest rates and favourable tax treatment for mortgage loans[4]. Furthermore, product innovation and the increased use of capital market funding to finance these new products has led to improved access to mortgage credit for previously credit constrained households[5].

1 *HYPOSTAT 2005: A review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2006, p. 140.
2 Cf. footnote 1.
3 Cf. footnote 1, p. 129.
4 *Structural Factors in the EU Housing Markets*, European Central Bank, March 2003, p. 6 and 45.
5 Cf. footnote 4, p. 6.

Graph 1: Residential mortgage debt to GDP ratio (%)



Source: *Hypostat 2005: A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2006.

The structure of EU housing markets also varies considerably with owner occupation rates ranging from 43.2% in Germany and 46.8% in the Czech Republic to 97.2% in Romania and 97.9% in Lithuania. The share of rented dwellings in the total stock of housing has in general been falling in recent years[6] due to a fall in the supply of rental accommodation and tax systems that are favourable to owner-occupied housing. Also, in recent years, due to falling interest rates, it has generally been more economical to buy than to rent[7].

Table 1: Owner occupation rate (%)

Country	Latest available data	Owner occupation rate
Belgium	2001	68,0
Czech Republic	2001	46,8
Denmark	2004	52,0
Germany	2002	43,2
Estonia	2002	85,2
Greece	2004	74,3
Spain	2004	83,0
France	2002	56,2
Ireland	2004	77,0
Italy	2002	80,0
Cyprus	2001	68,3
Latvia	2005	86,0
Lithuania	2004	97,9

6 Cf. footnote 4, p. 5.
7 Cf. footnote 4, p. 6.

Luxembourg	2002	66,6
Hungary	2003	92,2
Malta	2000	74,1
Netherlands	2002	54,2
Austria	2003	56,8
Poland	2004	75,0
Portugal	2003	75,0
Slovenia	2003	84,0
Slovakia	2001	49,2
Finland	2005	64,0
Sweden	2003	48,8
United Kingdom	2004	71,0
EU25 average		65,0
Bulgaria	2002	96,5
Romania	2002	97,2

Source: *Hypostat 2005: A Review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2006.

European mortgage markets and housing markets are closely linked. For instance, increased demand for housing (i.e. due to population growth, a wider range of products or a fall in interest rates) can put upward pressure on house prices thereby increasing household assets. This may in turn lead to consumers 'trading-up' and/or withdrawing equity from their houses to finance, for example, consumption, therefore compounding the effects of the initial impact.

In conclusion, the differences in both the structure of EU mortgage markets as well as the differences in the underlying structure of housing markets mean that the impact of any measures taken at the European level will vary depending on the size of the market and its relative importance in the national economy.

1.1. Convergence in mortgage interest rates

Prices are an important indicator when monitoring integration. In an integrated market, prices should theoretically converge ('law of one price') because of competition between financial services providers. Comparing the prices of retail financial products cross-border is, however, not without its difficulties. The different legal and economic environments in which products are offered mean that many of the key features of products, and thus the prices, differ[8].

Over the last 10 years, the level of mortgage interest rates has fallen across Europe in line with the reduction in nominal interest rates[9]. Several studies have also examined price convergence using different techniques (adjusted prices, non-adjusted prices, harmonised interest rates, etc.)[10]. Despite the different approaches, however, studies agree that – in

8 Features that may differ include the interest rate structure, tax, consumer risk profile, early repayment options (and costs), mortgage lenders fees, etc.

9 See for example, *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 44; *European mortgage markets – 2006 adjusted price analysis*, Mercer Oliver Wyman and the European Mortgage Federation, February 2006, p. 4.

10 See for example, *Financial Integration Monitor – 2005 – Background document*, Commission Staff Working Document, June 2005, p. 35; *Study on the Financial Integration of European Mortgage Markets*, Mercer Oliver Wyman and the European Mortgage Federation, October 2003, p. 35; *European mortgage markets – 2006 adjusted price analysis*, Mercer Oliver Wyman and the European Mortgage Federation, February 2006, p. 5; *Risk and Funding in European Residential Mortgages*, Mercer Oliver

general terms – there has been some convergence in the price of mortgage credit across Europe. Convergence appears largely to be driven by general macroeconomic convergence and the introduction of the euro[11]. Since the introduction of the euro, convergence has been more limited[12]. It should however be noted that the range in prices is already quite small[13].

1.2. A range of mortgage products are available across the EU – but not in every market

The range of products available to consumers in EU mortgage markets may be considered in two ways:

- the availability of products with different characteristics, for example, interest rate structures (variable, fixed, etc.), repayment structures (is early repayment available and under what type of conditions), etc.

- the availability of products for all kinds of borrowers, including the so-called 'non-conforming' or 'sub-prime borrowers' which are generally defined as borrowers who may face difficulties in obtaining credit from mainstream mortgage lenders[14], for example, because they have an impaired or insufficient credit history, cannot prove their income (e.g. self-employed), fall outwith a range of certain income or loan to value ratios, or individuals buying to let property.

A wide range of products is currently available on primary markets for borrowers in the EU. No single country, however, could be seen to have a complete range of products available either in terms of product characteristics or borrowers served.

Table 2: Product availability for non-conforming borrowers, by borrower type

	Aged 50+	Low equity (LTV > 90)	Previously bankrupt	Self-certified income	Credit impaired	Self-employed
Austria	Good/Limited	Good/Limited	Limited/ Not available	Limited	Limited/ Not available	Limited
Belgium	Good	Good	Limited	Good	Limited	Limited
Czech Republic	Good	Good	Limited	Not available	Limited	Good
Denmark	Good	Good	Not available	Good	Good	Good
Estonia	Good	Limited	Limited	Good	Limited	Good
Finland	Good	Good	Limited	Good	Limited	Good

Wyman and the Mortgage Insurance Trade Association, April 2005, p. 18; *Interim report II: current accounts and related services*, European Commission, 17.7.2006, p. 162.

11 *Financial Integration Monitor – 2005 – Background document*, Commission Staff Working Document, June 2005, p. 35.

12 According to one study, there appears to be 'no evidence of a convergence of mortgage spreads within the euro zone since the euros adoption', *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 49. Another study concludes that 'the range in prices has not changed over the period [2003–2006]', *European mortgage markets – 2006 adjusted price analysis*, Mercer Oliver Wyman and the European Mortgage Federation, February 2006, p. 5.

13 See for example, *European mortgage markets – 2006 adjusted price analysis*, Mercer Oliver Wyman and the European Mortgage Federation, February 2006, p. 5.

14 See for example, Financial Services Authority http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/practice/sub_prime.shtml.

France	Good	Good	Limited	Limited	Not available	Good
Germany	Good	Good	Limited	Limited	Not available	Good
Greece	Good	Limited	Not available	Limited	Not available	Good
Hungary	Limited	Limited	Not available	Good	Good	Good
Ireland	Good	Good	Limited	Limited	Limited	Good
Italy	Good	Limited	Limited	Limited	Limited	Good
Latvia	Limited	Limited	Limited	Good	Limited	Good
Lithuania	Good	Good	Limited	Limited	Limited	Good
Luxembourg	Limited	Limited	Limited	Good	Limited	Good
Malta	Good	Good	Limited	Good	Limited	Good
Netherlands	Good	Good	Limited	Good	Limited	Good
Poland	Good	Good	Good	Not available	Not available	Limited
Portugal	Good	Good	Not available	Limited	Limited	Good
Slovakia	Limited	Good	Limited	Limited	Not available	Good
Slovenia	Good	Limited	Not available	Limited	Limited	Limited
Spain	Good	Good	Limited	Limited	Limited	Good
Sweden	Good	Good	Limited	Good	Limited	Good
United Kingdom	Good	Good	Limited	Good	Good	Good

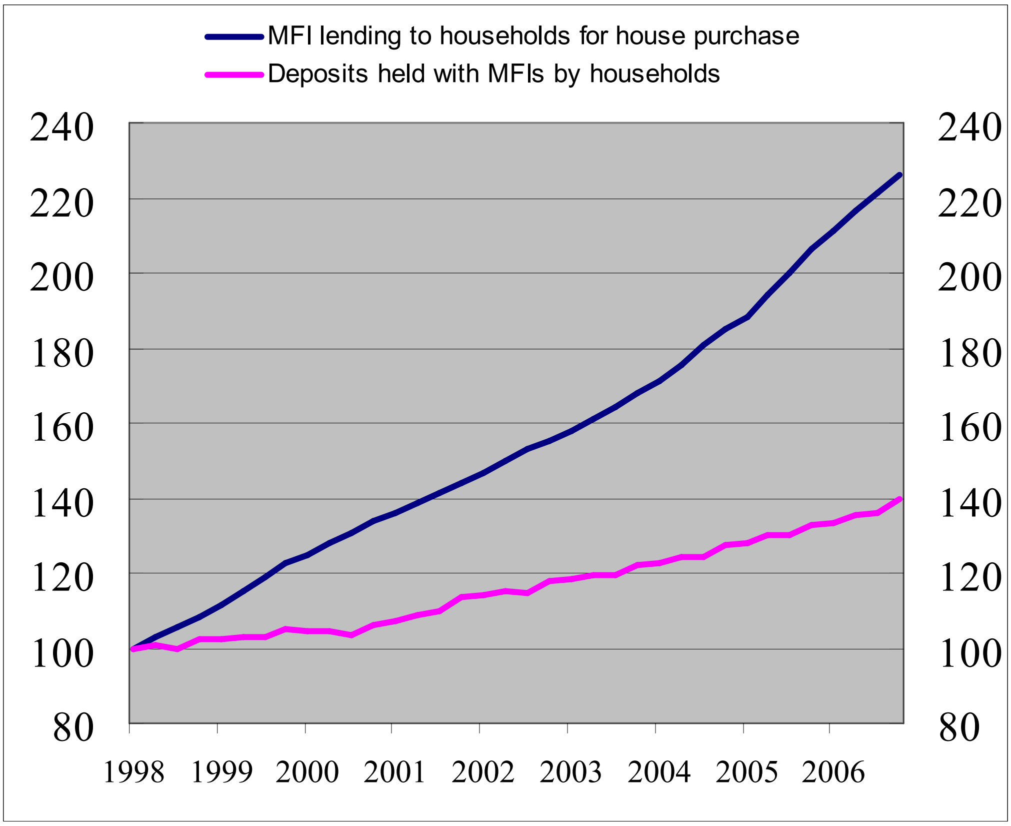
Source: *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 138. (Based on data from London Economics survey; for The Netherlands, Poland: *Risk and Funding in European Residential Mortgages*, Mercer Oliver Wyman and the Mortgage Insurance Trade Association, April 2005.) Data is missing for Bulgaria, Cyprus and Romania.

1.3. Mortgages continue to be funded via deposits

Although in the Euro area total deposits held by households have increased quite substantially, by around 33% between end-1999 and end-2006, lending to households for house purchase has been much more dynamic, i.e. it grew by around 83% in the same period[15]. Consequently, mortgage lenders have increasingly turned to capital markets to finance mortgage credits.

15 European Central Bank.

Graph 2: Evolution of household deposits and loans for house purchase (1Q 1998 to 4Q 2006) (1Q 1998 = 100)



Source: European Central Bank

According to the most recent statistics, retail deposits accounted in 2005 for approximately 70%[16] of mortgage funding and remain the predominant form of mortgage finance in the majority of Member States. The use of capital market products such as covered bonds and residential mortgage backed securities as well as newer products such as whole loan sales and temporary warehousing facilities is gaining in importance[17].

Although detailed statistics on the funding structure of EU mortgage funding markets are scarce, funding by residential and commercial covered bonds is estimated at about 17.5%, and funding by Residential Mortgage Backed Securities (excluding commercial mortgage backed securities) is approximately 10% of outstanding EU residential mortgage balances[18]. The remainder of EU residential mortgages are assumed to be financed by unsecured lending, e.g. via other bonds issued by the financial institution[19]. The extent to which different funding techniques are used varies considerably between countries.

---

16 Cf. footnote 1, p. 23. Based on raw estimates on the basis of 2005 data.
17 *Report of the Mortgage Funding Expert Group*, 22.12.2006, p. 3.
18 Cf. footnote 17.
19 Cf. footnote 17.

2. MORTGAGE LENDERS IN THE EU

2.1. Mortgages are the principle source of income for European retail banks

According to recent research by the Commission[20], mortgages appear to be the most significant source of income in retail banking in the EU, generating 30% of total gross income from personal customers in 2004. The annual gross average income per customer is EUR 1 015 ranging from EUR 1 787 in Spain to EUR 321 in Lithuania[21].

2.2. Tying and cross-selling are prevalent with mortgage credit products[22]

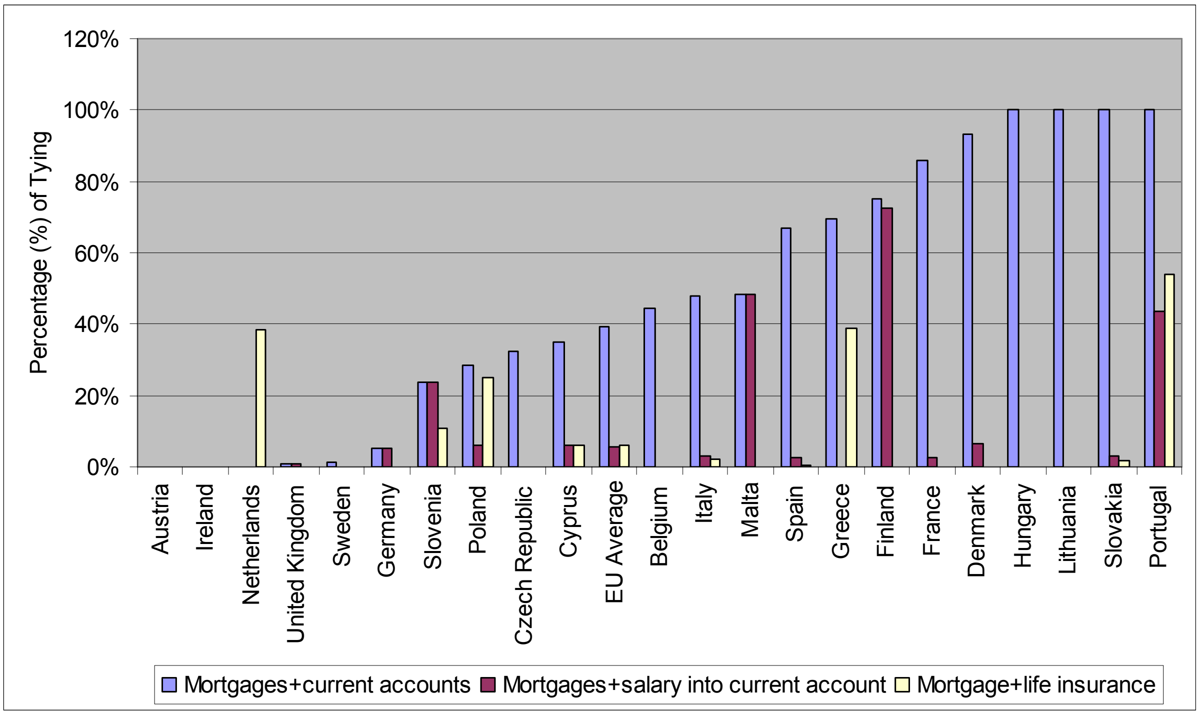
Mortgage lenders have strong incentives to cross-sell products. They use bundling[23] and tying[24] widely in their cross-selling strategies. Bundling occurs where two or more products are sold together in a package, although each product is also available separately. The products may only be available as a bundle (pure bundling) or may be available separately but offered at a discount relative to their individual prices (mixed bundling). Tying occurs when two or more products are sold together in a package and at least one of these products is not sold separately.

These practices can offer both advantages and disadvantages to the consumer. On the one hand, cross-selling may enable banks to offer a range of tailored products to the consumer and generate savings in the production, distribution and transaction costs thereby providing the products at a lower cost to the consumer. On the other hand, bundling and product tying may weaken competition, by making price comparisons difficult and deterring switching[25].

---

20 *Report on the retail banking sector inquiry*, SEC(2007) 106, European Commission, 31.1.2007, p. 21.
21 *Interim report II: current accounts and related services*, European Commission, 17.7.2006, p. 69.
22 Information taken largely from: cf. footnote 21, p. 106 and footnote 20, p. 59.
23 Cf. footnote 20, p. 49 and footnote 21, p. 96.
24 Cf. footnote 20, p. 42.
25 Cf. footnote 20, p. 49.

Graph 3: Sampled banks reporting product tying, weighted by banks' combined share of customer numbers in the lead product



Source: *Report on the retail banking sector inquiry*, SEC(2007) 106, European Commission, 31.1.2007, p. 61.

A recent inquiry by the Commission[26] found significant levels of current account tying in the mortgage market at 39%. The incidence of tying life insurance to a mortgage credit or the payment of a salary into a current account was less common[27].

Cross-selling ratios are also highest with mortgages. On average, a consumer purchasing a mortgage buys an additional two products from the same mortgage lender[28]. In some Member States, cross-selling is even higher, for instance in Belgium and France, consumers purchasing a mortgage credit generally buy a total of 4.53 and 4.27 products respectively[29].

---

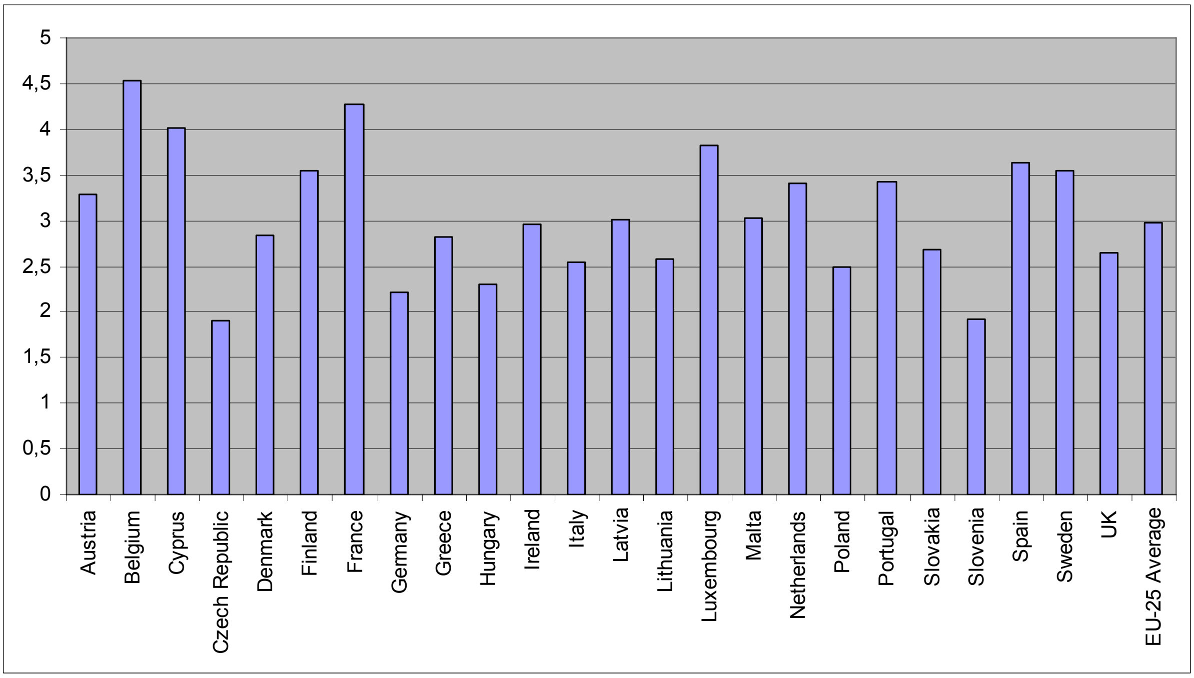
26 Cf. footnote 20, p. 61.

27 Cf. footnote 20, p. 61 and footnote 21, p. 109.

28 Cf. footnote 21, p. 106.

29 Cf. footnote 21, p. 106.

Graph 4: Cross-selling ratio of mortgages to consumers weighted average (2005)



Source: *Interim report II: Current accounts and related services*, European Commission, 17.7.2006, p. 106.

2.3. Cross-border activity by mortgage lenders exists and has growth potential

It is important to recognise that it is difficult to analyse the extent to which mortgages are offered cross-border, since few statistics on the mortgage sub-sector exist[30], however, information on the banking sector as a whole can enable some general observations.

First, information from both consumers and mortgage lenders respectively confirms the fact that most mortgage transactions are conducted locally[31]. The locally available products can however either be provided by a domestic mortgage lender or by a foreign mortgage lender through a local presence. In terms of **branches and subsidiaries**, the presence of foreign banks varies considerably between different Member States, ranging from about 5% in countries such as Italy or Germany to over 90% in some of the new Member States[32]. Surveys from 1996 and 1998 by the European Mortgage Federation found that mortgage lenders from Belgium, UK, Denmark, France, Germany, Norway and Portugal operate in other EU Member States, mainly through branches in the host country[33]. A recent survey of pan-EU mortgage lenders also found that physical presence is particularly important in the mortgage business since most sales are conducted with branches[34]. Consolidation in the EU financial

30 *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, pp. 37–38.

31 See for example, *Public Opinion in Europe – Financial Services*, Eurobarometer 205, January 2004, p. 58; *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005, p. 39; and footnote 30, p. 57.

32 Cf. footnote 30, p. 38 (based on 2003 data).

33 Cf. footnote 30, p. 38, based on European Mortgage Federation data.

34 Cf. footnote 30, p. 41. Survey of 8 Pan-European mortgage lenders from Austria, Denmark, Germany, Spain, the UK and the US.

sector, in terms of **mergers and acquisitions**, is also underway. However, in general, domestic consolidation continues to prevail over cross-border[35].

Second, although more rarely, mortgages can also be offered cross-border. Alternative distribution channels, such as the **Internet** or **credit intermediaries** are also increasingly being used to engage in cross-border activity. One survey of financial services providers found that 11% of mortgage lenders reported making a 'substantial' number of loans to borrowers in countries where they had neither a branch nor a subsidiary, with another 32% doing so rarely[36]. A further survey of pan-EU financial services providers found that direct cross-border lending existed but was currently more common in border regions, e.g. Ireland/UK, Germany/Austria, or Scandinavia[37].

Despite the relatively limited cross-border activity, in a recent survey of cross-border mortgage lenders, many expressed a significant interest in developing their activities in countries where they did not already have a subsidiary or branch presence[38]. Establishing a branch or a subsidiary appears the most common form of interest in developing a cross-border business[39]. Mortgage lenders also expressed a relatively high interest in merging or acquiring an existing mortgage lender[40]. One increasingly popular alternative to distribution via local ownership is credit intermediaries. Almost half the mortgage lenders surveyed reported that they were interested in making more mortgage loans through credit intermediaries in another EU Member State in the next five years, making this the third most popular strategy behind the establishment of branches or subsidiaries[41].

---

35 *Financial Integration Monitor – 2005 – Addendum on Cross-border consolidation in the EU25*, Commission Staff Working Document, November 2005, p. 59 and *Cross-border consolidation in the EU financial sector*, Commission Staff Working Document, 26.10.2005, p. 7.

36 Cf. footnote 30, p. 61. Survey by PriceWaterhouse Coopers on behalf of London Economics contacted 63 mortgage lenders from 18 EU countries (The participants in the survey were from Cyprus, Czech Republic, Estonia, Finland, Germany, Greece, Hungary, Ireland, Italy, Latvia, Poland, Portugal, Slovakia, Slovenia and the UK).

37 Cf. footnote 30, p. 41. Survey of 8 Pan-European mortgage lenders from Austria, Denmark, Germany, Spain, the UK and the US.

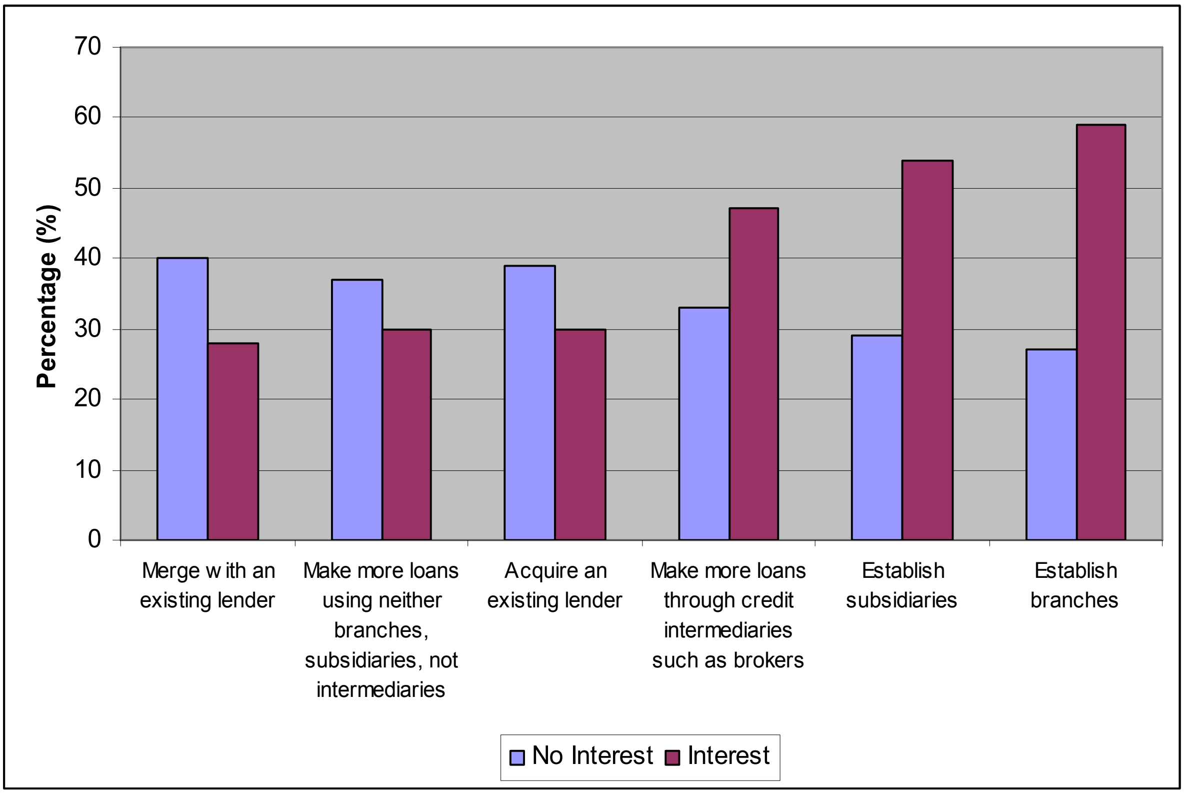
38 Cf. footnote 36.

39 Cf. footnote 36.

40 Cf. footnote 36.

41 Cf. footnote 36.

Graph 5: Strategies of firms in next 5 years in EU countries where they have no subsidiary or branch presence



Source: *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 61

30% of providers were also interested in cross-border activity in another EU Member State neither using branches/subsidiaries nor intermediaries in the next five years, illustrating some potential for direct cross-border activity in the future[42]. Mortgage lenders from the new EU Member States expressed a greater interest in entering a foreign market using direct cross-border trade and credit intermediaries than mortgage lenders with their home base in the EU15, who preferred using subsidiaries[43]. The survey of mortgage lenders already active EU-wide also indicated that although the use of the internet and telemarketing remains small, it is an area of the business that mortgage lenders would like to develop in the future[44].

3. MORTGAGE BORROWERS IN THE EU

Consumers may purchase their mortgage in two main ways: locally from a domestic or foreign provider; or in another Member State via a range of distribution channels.

Retail financial services products continue to be predominantly purchased domestically. A minority of products may, however, be offered to domestic consumers to purchase a property abroad. In a survey by London Economics, mortgage lenders stated that in terms of cross-border activity it was more common to provide mortgage loans to domestic borrowers

42 Cf. footnote 36.
43 Cf. footnote 36.
44 Cf. footnote 37.

to purchase property abroad, than to provide cross-border loans to consumers in another Member State[45]. This niche market has grown in recent years: in the UK, for example, between 1999/2000 and 2003/2004, the number of second homes abroad increased by 45%[46]. Moreover, the trend is forecasted to continue, with numbers expected to double over the next five to seven years[47]. The percentage of consumers purchasing cross-border financial services is also limited. This is particularly true for mortgage products, with virtually no EU consumers purchasing mortgage products cross-border, although in some Member States such as Netherlands, Belgium and Luxembourg this figure is very slightly higher (1%)[48].

At the same time, surveys indicate that although the majority of consumers intend to continue to shop locally for their mortgages, a few would consider shopping around cross-border. According to one recent Eurobarometer survey[49], 3% of consumers indicated that they would consider obtaining a mortgage from a firm located in another country of the EU within the next 5 years. This number however varies in size depending on the country, with consumers from countries such as France (5%), Ireland (8%), Austria (5%), Finland (6%) and the UK (9%) being more likely to consider going cross-border for mortgage credit. In addition, according to a survey of EU consumers by London Economics[50] many respondents would consider a cross-border mortgage transaction[51].

The reasons why the large majority of consumers still do not demand cross-border products should be examined in more detail. According to a recent Eurobarometer, almost a quarter of those surveyed did not believe it possible to obtain a mortgage in another EU Member State[52]. Another Eurobarometer survey asked consumers what they see as the main barriers to shopping for financial services cross-border[53]. Around one quarter of consumers surveyed felt that a lack of information is an obstacle for consumers using financial services elsewhere in the EU[54]. Just over 10% also felt that poor legal protection in the event that something goes wrong was an obstacle for consumers[55]. It should however be kept in mind that only 3% of consumers currently consider obtaining a mortgage from a firm located in another country of the EU within the next five years[56].

---

45 Cf. footnote 37.

46 'Britons spend £23bn on a place in the sun', *The Telegraph*, 21 February 2006, based on statistics from the UK Office of National Statistics.

47 Cf. footnote 46.

48 *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005, p. 39 and annex (Q4a). It should be noted that this figure excludes consumers purchasing a mortgage locally to finance a property abroad.

49 Cf. footnote 48, p. 42 and annex (Q4b).

50 Cf. footnote 30, p. 60. The survey – conducted by PWC on behalf of London Economics – covered 217 consumers from four EU countries (Germany, Poland, Spain and the UK).

51 Cf. footnote 50.

52 *Internal Market – opinions and experiences of citizens in EU-25*, Eurobarometer 254, October 2006, p. 59, annex (QD6.2).

53 Cf. footnote 48, p. 47 and annex (Q4c).

54 Cf. footnote 48, p. 47 and annex (Q4c).

55 Cf. footnote 48, p. 47 and annex (Q4c).

56 Cf. footnote 48, p. 42 and annex (Q4b).