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COMMISSION STAFF WORKING DOCUMENT

Accompanying the

White Paper on the Integration of EU Mortgage Credit Markets

IMPACT ASSESSMENT

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1. INTRODUCTION

Retail financial services are essential for the everyday lives of EU citizens. It is widely recognised that a mortgage credit linked to a house purchase is, for most EU citizens, the biggest financial investment of a lifetime. EU mortgage credit markets also represent a significant aspect of Europe's economy, with outstanding residential mortgage credit balances representing almost 47% of the EU GDP[1].

Completing the Single Market in financial services is an integral part of the Lisbon economic reform process; and essential for the EU's global competitiveness. However, although significant progress has been made in constructing a Single Market for financial services, retail financial services integration has not yet reached its potential and competition in some markets is insufficient, leaving EU consumers and mortgage lenders unable to take full advantage of the benefits of the Single Market. As such, without further efforts, European retail financial markets are likely to remain fragmented.

For several years, the Commission has engaged in a comprehensive review of European residential mortgages markets. This review of European mortgage markets should be placed against the background of the Commission's White Paper on Financial Services 2005–2010[2], the results of the Commission's sector inquiry into retail banking[3], the Green Paper on Retail Financial Services[4] and the Communication on a Single Market for 21st Century Europe[5]. The review covers credit agreements secured by a mortgage or by another comparable surety commonly used on immovable property as well certain credit agreements the purpose of which is acquiring property rights. It is mainly focussed on residential mortgages, but it may also have implications, in a few instances, for commercial mortgages.

The Commission's policy decisions are presented in a White Paper on Mortgage Credit. In line with the Commission's better regulation approach, any policy orientations need to be carefully considered and their impact thoroughly assessed beforehand. Accordingly, this

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1 *HYPOSTAT 2005: A review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2006, p. 140.
2 COM(2005) 629, 5.12.2005.
3 COM(2007) 33, 31.1.2007 and SEC(2007) 106, 31.1.2007.
4 COM(2007) 226, 30.4.2007.
5 COM(2007) 724, 20.11.2007 and SEC(2007) 1520, 20.11.2007.

report, which is based on the results of a series of consultations and studies over the period 2003–2007, will identify the problems in EU mortgage markets; set out the objectives of the Commission's policy in the field of mortgage credit; consider the different policy options with which to achieve them; and assess their potential impact. Policy decisions presented in the White Paper will subsequently be further developed in close cooperation with all relevant stakeholders and will be subject to proportionate impact assessments before adoption.

2. EU MORTGAGE MARKETS

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[6]. The size of the 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[7].

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[8]. Mortgage debt to GDP ratios have risen steadily across the majority of 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[9]. 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[10].

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[11] 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[12].

European mortgage markets and housing markets are closely linked. For instance, an 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 (e.g. consumption), thus compounding the initial effects.

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.

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6 Cf. footnote 1, p. 140.
7 Cf. footnote 1, p. 140.
8 Cf. footnote 1, p. 129.
9 *Structural Factors in the EU Housing Markets*, European Central Bank, March 2003, p. 45.
10 Cf. footnote 9, p. 6.
11 Cf. footnote 9, p. 5.
12 Cf. footnote 9, p. 6.

2.1. EU mortgage markets – competitive but room for improvement

EU mortgage markets are generally quite competitive on a national level offering a range of products at increasingly lower interest rates.

A wide range of products is currently available for borrowers in the EU. However, no single country could be seen to have a complete range of products available either in terms of product characteristics or borrowers served[13]. Studies estimate that a large 'latent demand' for mortgage borrowing exists in several EU countries, which could potentially be filled by the availability of a wider range of products[14].

The level of mortgage interest rates has fallen across Europe during the last ten years, driven largely by the reduction in nominal interest rates. Interest rates have also converged[15], largely due to general macroeconomic convergence and the introduction of the euro[16]. However, according to recent research by the Commission[17], despite this downward trend in interest rates, mortgages appear to remain the most significant source of income for retail banks in the EU, generating 30% of total gross income from personal customers in 2004.

2.2. Interest of mortgage lenders in cross-border activity

It is difficult to analyse the extent to which mortgages are offered cross-border, since few statistics on the mortgage sub-sector exist[18], however, information on the banking sector as a whole enables some general observations.

Information from both consumers and mortgage lenders respectively confirms the fact that most mortgage transactions are conducted locally, with virtually no EU consumers purchasing mortgage products cross-border[19]. A recent survey of pan-EU mortgage lenders found that physical presence is particularly important in the mortgage business since most sales are conducted with branches[20]. This confirms the results of earlier studies which found that those mortgage lenders that operate in other EU Member States do so mainly through branches in the host country[21]. However, the presence of foreign banks in terms of branches and subsidiaries 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[22].

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13 See Annex 2 for further information.

14 *The Costs and Benefits of Integration of EU Mortgage Markets*, London Economics, August 2005, p. 19 and *Risk and Funding in European Residential Mortgages*, Mercer Oliver Wyman and the Mortgage Insurance Trade Association, April 2005, Chapter 4.

15 See for example, *European mortgage markets – 2006 adjusted price analysis*, Mercer Oliver Wyman and the European Mortgage Federation, February 2007, p. 5.

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

17 *Report on the retail banking sector inquiry*, SEC(2007) 106, European Commission, 31.1.2007, p. 31.

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

19 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 18, p. 57.

20 Cf. footnote 18, p. 41.

21 Cf. footnote 18, p. 38. Based on European Mortgage Federation data.

22 Cf. footnote 18. Based on 2003 data.

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[23]. Establishing a branch or a subsidiary appears the most common form of interest in developing a cross-border business but mortgage lenders also expressed a relatively high interest in merging or acquiring an existing mortgage lender[24].

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[25].

Almost half the mortgage lenders questioned in the same survey 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[26]. 30% of providers were also interested in cross-border activity in another EU Member State <u>neither</u> using branches/subsidiaries <u>nor</u> intermediaries in the next five years, illustrating some potential for direct cross-border activity via, for example the internet or telemarketing, in the future[27].

In conclusion, cross-border activity by mortgage lenders currently remains the exception rather than the rule. Where cross-border activity takes place, it has mainly been done through the establishment of branches or subsidiaries, due to the importance of a local presence for consumers. However, that pattern is evolving and many mortgage lenders are increasingly looking at alternative distribution channels such as credit intermediaries. Significantly, a majority of mortgage lenders express a keen interest in developing their cross-border activities.

2.3. Interest of mortgage borrowers in cross-border activity

The percentage of consumers purchasing cross-border financial services is 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 the Netherlands, Belgium and Luxembourg this figure is very slightly higher (1%)[28]. 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 to purchase property abroad, than to provide cross-border loans to consumers in another Member State[29].

Surveys indicate that although the majority of consumers intend to continue to shop locally for their mortgages, 3% would consider obtaining a mortgage from a firm located in another

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23 Cf. footnote 18, p. 61.
24 Cf. footnote 18, p. 61.
25 Cf. footnote 18, p. 61.
26 Cf. footnote 18, p. 61.
27 Cf. footnote 18, p. 61.
28 *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.
29 Cf. footnote 18, p. 41.

country of the EU within the next 5 years[30]. 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[31] many respondents would consider a cross-border mortgage transaction.

3. PROCEDURAL ISSUES

The Commission's better regulation principles foresee that a thorough analysis of issues at stake in European mortgage markets be undertaken before any measures are proposed. In this regard, the Commission has followed a coherent consultative process which meets the Commission's minimum consultation standards.

3.1. Consultation of interested parties

This section provides a brief summary of the main consultation steps. Further information is available in Annex 2.

The Commission has initiated a transparent and consultative process to assess the case for Commission intervention. A **Forum Group on Mortgage Credit**, representing all actors in the area of the mortgage market, was established to identify the main barriers to the development of an integrated market for mortgage credit. The Group reported in December 2004 providing 48 recommendations on creating a pan-European mortgage credit market[32].

A **Green Paper on Mortgage Credit in the EU**[33] was published in July 2005. The Green Paper examined the case for Commission action, looking at whether and how Commission action to develop the single market in mortgages could enhance efficiency and competitiveness and provide concrete benefits for EU consumers. The publication of the Green Paper launched a public consultation which ended in December 2005 with a **public hearing** in Brussels[34].

The consultation on the Green Paper raised several issues on which it was decided that further analysis was required. The Commission therefore established Expert Groups to go into more detail on specific aspects, namely mortgage funding and certain consumer protection issues. The **Mortgage Funding Expert Group** was established in April 2006 to identify the barriers to integration for each of the funding models outlined in the Forum Group report, prioritise the barriers identified, and consider possible solutions. In April 2006, DG Internal Market and Services and DG Health and Consumer Protection launched the **Mortgage Industry and Consumer Dialogue** to explore to what extent common principles on four key consumer protection issues, namely information, advice, early repayment and annual percentage rate

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30 Cf. footnote 28, p. 42 and annex (Q4b).

31 Cf. footnote 18, p. 60.

32 *The Integration of EU Mortgage Credit Markets: Report by the Forum Group on Mortgage Credit*, December 2004. For further information see: http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/2004-report-integration_en.pdf.

33 COM(2005) 327, 19.7.2005.

34 Further information about the hearing is available at: http://ec.europa.eu/internal_market/finservices-retail/home-loans/integration_en.htm#greenpaper.

(APR), could be agreed upon. The reports of the two groups were published in December 2006 and January 2007 respectively[35].

The **European Parliament**'s response to the Green Paper on Mortgage Credit (the Purvis Report) was adopted on 14 November 2006[36]. The **European Economic and Social Committee**'s response to the Green Paper was adopted on 15 December 2005[37].

The **Government Expert Group on Mortgage Credit** was established in early 2005 to advise the Commission on its policy on mortgage credit. It is composed of Member State representatives from all EU Member States, plus some EFTA countries and has met on three occasions.

Several **meetings with market participants on mortgage credit** were held throughout the consultative process cumulating in a roundtable with all relevant stakeholders on 27 October 2006. The purpose of these meetings was to ensure that all stakeholders were kept up-to-date with the process and had the opportunity to provide additional information and further opinions to targeted questions raised by the Commission.

Since its establishment in April 2004, **FIN-USE**[38] has been closely associated in the development of the Commission's policy, discussing mortgage credit on several occasions and producing two opinions[39]. The **Financial Services Consumer Group**[40] has also been associated to the Commission's work on mortgage credit since its establishment in mid-2006.

3.2. Studies

To complement the extensive consultation of stakeholders and the work of the Commission an independent academic study was undertaken. The study, carried out by London Economics, on *The Costs and Benefits of Integration of EU Mortgage Credit Markets* was published on 5 August 2005[41].

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35 The report of the Mortgage Funding Expert Group is available at: http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/mfeg/final_report-en.pdf and the report of the Mortgage Industry and Consumer Expert Group at: http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/miceg/final_report-en.pdf.

36 European Parliament resolution on mortgage credit in the EU (2006/2102(INI)), 14.11.2006, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2006-0487+0+DOC+XML+V0//EN&language=EN.

37 Opinion of the European Economic and Social Committee on the Green Paper: Mortgage Credit in the EU, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_065/c_06520060317en01130119.pdf.

38 FIN-USE was set-up by the European Commission in 2004 as an expert forum to help it meet the need to improve policy-making in the field of financial services by including a user perspective. Further information is available at: http://ec.europa.eu/internal_market/fin-use_forum/about/index_en.htm.

39 Opinion on the Forum Group on Mortgage Credit Report *The Integration of the EU Mortgage Credit Markets*, 18.4.2005 and Opinion on the European Commission *Green Paper Mortgage Credit in the EU*, 30.11.2005. Both opinions are available at: http://ec.europa.eu/internal_market/fin-use_forum/documents/index_en.htm.

40 The Financial Services Consumer Group (FSCG) is a sub-group of the already existing European Consumer Consultative Group (ECCG). The overall objective of the Financial Services Consumer Group is to ensure that consumer interests are properly taken into account in EU financial services policy development. Further information is available at: http://ec.europa.eu/internal_market/finances/fscg/index_en.htm.

41 See http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/2005-report-integration-mortgage-markets_en.pdf.

The study's objective was to analyse and provide a quantitative assessment of the costs and benefits for the European economy of integrating mortgage credit markets, taking into account the impact on mortgage lenders and consumers. It provided a description of EU mortgage markets and the extent to which they are already integrated, including an assessment of cross-border trade in mortgage credit services as well as an examination of current trends and an analysis as to how these might impact on the cross-border situation. The study also assessed to what extent there was consumer and mortgage lender appetite for a pan-EU mortgage market.

3.3. Impact Assessment Steering Group

An Interservice Impact Assessment Steering Group was established in September 2006. The Steering Group was chaired by DG Internal Market and Services and representatives of DG Health and Consumer Protection, DG Enterprise, DG Competition, DG Economic and Financial Affairs, DG Justice, Freedom and Security, DG Taxation and Customs Union, the Secretariat General and the European Central Bank, all actively participated in the preparation of the Impact Assessment. The Steering Group met on two occasions: 5 July 2007 and 10 September 2007.

3.4. How input from the contributions has been used

The better regulation process has confirmed that a business case for European intervention in the field of mortgage exists. The consultative process has also enabled the Commission to better understand the views and priorities of different groups of stakeholders. This information is incorporated throughout Annex 3, the results of which are summarised in the subsequent sections.

3.4.1. Benefits from integration

The overwhelming majority of contributors recognise that there is a genuine need for an integrated EU mortgage credit market and that overall Europe would gain from such integration. While industry representatives view national mortgage markets as broadly efficient and competitive and argue that this competitiveness makes foreign market penetration difficult, they also acknowledge that further market integration could bring concrete benefits to both consumers and lenders. Consumer representatives generally argue that the EU could potentially benefit from the integration of the EU residential mortgage credit markets through lower prices arising from increased competition. However, they caution that these benefits would be undermined if integration jeopardises consumers' confidence or if customer mobility is impeded.

Stakeholders however disagree on the magnitude and the distribution of the benefits that can be achieved from integration. According to the London Economics study, the net present value to the EU economy of such increased integration is estimated at EUR 94.6 billion by 2015. By this date the study estimates that integration of the EU mortgage credit market would raise EU GDP by 0.7% and private consumption by 0.5%. The benefits are attributed to enhanced market completeness as well as increased competition and a more efficient allocation of resources.

Several of the contributions to the Green Paper on Mortgage Credit however criticised the methodological approach taken in this study. The criticisms of the study fall into two broad categories:

- Size of the benefits. Stakeholders, including both consumer and industry representatives, questioned the size of the estimated benefits. In general, stakeholders felt that the GDP forecasts were over-estimated. Industry representatives stated that the costs of implementing the different measures were underestimated.

- Distribution of benefits. Several stakeholders argued that the benefits would not be distributed evenly. Consumer representatives stated that an in-depth qualitative and quantitative consideration of the impact on consumers was lacking, e.g. the report did not consider the impact of its package on consumer confidence. Several stakeholders also questioned the distribution of benefits amongst Member States.

However, although the size of the estimated benefits was questioned, as said before, the fact that such benefits exist has not in itself been contested.

3.4.2. Integration will be supply rather than demand driven

Few respondents believe that there is, at least in the near future, a substantial consumer appetite for actively looking cross-border. Consumer and industry representatives alike concur with this conclusion. According to the contributions, including those from consumers and the mortgage lending industry, a more credible business model is that of mortgage lenders establishing branches or subsidiaries abroad, taking over local firms, using local credit brokers, or using the internet. Consumer representatives argue that the Commission should therefore focus on measures to improve competition in mortgage markets by promoting customer confidence and mobility (e.g. by improving information and advice, or abolishing tying) as well as by facilitating cross-border access for mortgage lenders. Mortgage lenders equally place a high value on addressing obstacles that deter lenders from operating cross-border (e.g. lack of access to the necessary information on potential borrowers, issues related to property valuation, land registration and foreclosure procedures, different national consumer protection provisions, and an inability to access secondary markets).

3.4.3. Divergent views on how to achieve integration

Although there is general agreement on the fact that integration of EU mortgage markets could bring certain benefits, the means to obtain the benefits is disputed.

On the one hand, a large majority of stakeholders (including consumers, the mortgage lending industry and Member States) agree that targeted harmonisation of, for example, the annual percentage rate of charge and non-discriminatory cross-border access to credit registers, could bring concrete benefits. There is also a consensus that non-binding measures should be favoured on issues such as land registration and property valuation and that market based rather than regulatory measures should be sought to address the problems in mortgage funding markets.

On the other hand, on certain issues, notably those impacting on the level of consumer confidence, such as pre-contractual information, advice, and early repayment, while some common themes did emerge on certain aspects, stakeholders diverged on the most appropriate policy response. On pre-contractual information, while there is a general agreement amongst stakeholders that the content and adherence to the Code of Conduct on Home Loans (the

Code)[42] could be improved, there are stark differences as to how that should be done. Consumers, along with a majority of Member States, favour converting the Code into binding legislation, whereas mortgage lenders, together with a minority of Member States, believe that the Code should remain in its current voluntary form. On advice, there are large divergences in the views of different stakeholders. Whereas consumers argue that the provision of advice by mortgage lenders should be obligatory, the majority of Member States and mortgage lenders strongly oppose any such move. Moreover, if advice is provided, consumers believe that it should meet certain standards. On this aspect, the majority of Member States concur while the majority of mortgage lenders remain opposed to any standards. The most controversial issue is early repayment. Consumer representatives advocate the need for a legal right to early repayment to promote customer mobility and competition. Although they agree that mortgage lenders should be entitled to compensation under certain circumstances, they believe the level of compensation should be capped. In contrast, mortgage lenders believe that early repayment should be a contractual right, negotiable between lender and borrower, and that the level of compensation must cover their actual costs. Member States' views fall between these two positions.

4. PROBLEMS

After a rigorous analysis of Europe's mortgage markets and taking into account the information collected through extensive consultations, four general problems have been identified: obstacles to the cross-border supply of mortgage credit; limited product diversity; low consumer confidence; and restricted customer mobility.

4.1. Obstacles to cross-border activity by mortgage lenders

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)[43]; 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.

At present, the distribution of mortgage products occurs predominantly through local channels (either via local mortgage lenders or, to some extent, foreign mortgage lenders operating locally) albeit with a limited portion taking place directly cross-border. Despite the relatively limited cross-border activity, in a recent survey[44] of mortgage lenders, a majority expressed an interest in developing their activities in countries where they did not already have a subsidiary or branch presence[45].

In a competitive and efficiently functioning single market, mortgage lenders would be able to enter and exit markets as they choose and operate as efficiently in another Member State as they would in their own. This can have an innovative effect by introducing new products, distribution methods, etc., thus promoting competition between mortgage lenders as well as

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

[43] The phenomena of consumers shopping around in another Member State for products is discussed further in Annex 1.

[44] Cf. footnote 18, p. 61.

[45] See Annex 2 for further details.

choice for consumers on the market and lower prices. However, pan-EU financial services providers are concerned about the barriers associated with cross-border trade[46].

4.1.1. *Primary markets*

Differing regulatory and consumer protection frameworks as well as fragmented infrastructures create legal and economic barriers to market entry.

- Economic barriers such as the costs of accessing infrastructures and the need to adapt products, business models and pricing strategies raise the costs of doing business in another Member State[47]. Although a certain degree of one-off costs can be expected by mortgage lenders seeking to operate cross-border, many of the economic barriers present higher ongoing costs for mortgage lenders. As such, these barriers deter market entrants, restrict consumer choice, limit competition and push up prices for consumers[48].

- Legal barriers may prevent or complicate the offering of certain products or accessibility to market infrastructures[49], thus limiting competition and stifling innovation. The costs of adapting the products and producing different materials in accordance with different national frameworks can limit economies of scale and scope and thus deter mortgage lenders from entering into cross-border activity[50]. In addition, in some countries, where it is required to be a credit institution in order to grant mortgage loans, it might not be possible for some mortgage lenders to do business at all, unless they become a credit institution[51]. Many of these legal restrictions, which exist to protect consumers[52] or the financial stability of the mortgage lender[53], may indirectly limit certain consumers (e.g. non-conforming borrowers) access to a mortgage loan. Balancing the benefits of product diversity with the need to protect consumers, to preserve financial stability and to ensure a level playing field among mortgage lenders are examined in more detail in Section 6.1 and Annex 3.

4.1.2. *Secondary markets*

Different mortgage funding frameworks across Europe create legal and economic barriers to the development of efficient mortgage financing strategies.

- Economic barriers[54] raise the cost of financing mortgage loans, thus reducing the opportunities for economies of scale and deterring mortgage lenders from using capital market mortgage financing instruments. Many of these barriers are faced by domestic and

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[46] Cf. footnote 18, p. 41.

[47] See for example, Annex 3, Sections 1.1. (pre-contractual information), 2. (early repayment), 3. (product tying), 4. (credit registers), 5. (property valuation), 6. (forced sales procedures), 7. (land registers), 10. (mortgage funding).

[48] Cf. footnote 17, p. 32.

[49] See for example Annex 3, Section 4. (credit registers).

[50] See for example Annex 3, Sections 1.1. (pre-contractual information) and 2. (early repayment).

[51] See for example, Annex 3, Section 11. (non-credit institutions and servicers).

[52] For example, restrictions on early repayment terms and conditions.

[53] For example, limits to loan to value ratios.

[54] See for example Annex 3, Sections 10.5. (data protection), 10.2. (residential mortgage backed securities), 10.3. (transferability of mortgage loan portfolios to third parties), 10.4. (reporting), 10.7. (house price indices), and 10.6. (Basel II).

internationally operating mortgage lenders alike, however the magnitude is more pronounced for institutions operating cross-border.

- Legal provisions[55] or the lack thereof in some Member States can also have a significant influence on the choice of funding techniques and thus on the products that may be offered. They may, for example, prevent the use of certain funding instruments, limiting a mortgage lender's funding strategies and/or raising the cost of financing for mortgage lenders.

The result is limited product diversity and higher prices for consumers. The development of mortgage funding instruments, in particular capital market instruments, could facilitate cross-border activity by enabling credit institutions wishing to enter a new (non-domestic) mortgage market to finance mortgage loans without the need to first develop a deposit base, i.e. by unbundling of the mortgage value chain. Furthermore, pan-European funding mechanisms have the potential to improve the efficiency of EU mortgage markets by increasing the sources of funding available, deepening the liquidity of the market and more generally allowing for the diversification of risk. Improved efficiency could potentially lead to lower prices for consumers.

4.2. Limited product diversity

In a fully competitive and efficient market, a variety of mortgage products would be available in each market and a wide range of borrowers would have access to mortgage credit products that meet their needs in a way which is convenient for them. 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[56]. This is due to several factors.

- Consumer preferences and cultural differences may have a role to play.

- Mortgage lenders may have different appetites for risk. Risk based lending is becoming increasingly prevalent in accordance with regulatory frameworks designed to maintain financial stability. The extent to which a mortgage lender is willing to offer high risk mortgage loans may also therefore depend on a mortgage lender's risk management and/or funding strategies.

- Economic and legal barriers exist in some Member States which prevent mortgage lenders from offering certain products in certain markets or choosing their preferred funding strategy (see Section 4.1.1. above).

These factors have two principle consequences: restricted choice on the demand side and reduced competition on the supply side.

- For consumers, product related barriers may have a direct impact by reducing the range of products on offer (e.g. products with different interest rate structures, repayment structures or equity release products) and risking excluding some groups of consumers from the market (e.g. 'non-conforming' or 'sub-prime borrowers' who may face difficulties in obtaining credit from mainstream mortgage lenders because they have an impaired or

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55 See for example Annex 3, Sections 10.1. (covered bonds) and 10.2. (residential mortgage backed securities).

56 See Annex 1 for further information.

insufficient credit history, cannot prove their income or fall outwith a range of certain income or loan to value ratios).

- Barriers to product diversity can prevent or discourage new market entrants.

While little can be done to alter consumer and/or mortgage lender preferences or strategies, economic barriers can be minimised and legal barriers removed.

4.3. Low consumer confidence

In a competitive and efficiently functioning single market, consumers will theoretically search for the best product offered for their needs, be it available in their own country or in another Member State. European consumers however continue to predominantly shop locally for their mortgage products: virtually no EU consumers purchase mortgage products directly cross-border, although in some Member States this figure is slightly higher (1%)[57]. At the same time, surveys indicate that although the majority of consumers intend to continue to shop locally for their mortgages, a few (3%) would consider shopping around directly cross-border in the future[58].

This phenomenon can be attributed, inter alia, to two main reasons: a lack of consumer awareness and lack of consumer confidence.

- Lack of consumer awareness, means that many consumers are unaware of what exists elsewhere (24% of consumers in a recent survey stated that the lack of information on opportunities elsewhere was a key reason for not taking out an insurance policy or mortgage product cross-border[59]).

- Many consumers lack the confidence to search for and take out products cross-border. Insufficient or bad information, fears about whether legal rights will be upheld, or poor legal protection in the event that something goes wrong, as well as the need to function in a different language have all been cited by consumers[60] as factors which prevent them operating cross-border[61]. Although consumers in some Member States, such as Romania, Poland or Austria, regularly take out loans in a foreign currency[62], other consumers might be deterred from shopping around in another Member State due to the exchange risks which they might occur (e.g. cross-border business between euro area Member States and those outside the euro area). Information asymmetries between the mortgage lender and borrower can, for example, distort the market. According to research by the European Commission, information provided to retail banking customers may be inadequate or complex, making it difficult to compare prices and choose between banks[63].

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57 Cf. footnote 28, p. 39 and annex (Q4a). It should be noted that this figure excludes consumers purchasing a mortgage locally to finance a property abroad.

58 Cf. footnote 28, p. 42 and annex (Q4b).

59 *Internal Market – opinions and experiences of citizens in EU-25*, Eurobarometer 254, October 2006, p. 59 (QD16).

60 Cf. footnote 28, p. 47 and annex (Q4c).

61 See for example, Annex 3, Sections 2. (early repayment), 1.1. (pre-contractual information) and 8. (applicable law).

62 *Republic of Poland: Financial Sector Assessment Program – Technical Note – Credit, Growth, and Financial Stability*, IMF Country Report Nr. 07/103, March 2007, p. 3.

63 Cf. footnote 17, p. 76.

4.4. Restricted customer mobility

Customer mobility and the propensity of consumers to switch mortgage lenders can influence the level of competition in a market. Theoretically, consumers should be able to access the relevant information to enable them to choose the most appropriate provider and product for their needs as well as have the ability to switch providers when the need to move house arises or a better offer becomes available. This would provide an incentive for mortgage lenders to compete more actively for consumers and thus lead to a more competitive market, thereby minimising the costs for the consumer that inevitably are attached to mobility.

Mortgage credit is a long-term product, with the duration of contracts ranging from about 10 to 40 years. Locking consumers into a long-term contract places severe limitations on consumer mobility, particularly if the consumer is also tied to the mortgage lender through other products such as a current account and/or life insurance policy.

The principle factors that influence mobility in terms of mortgage products are twofold: consumer preferences and high switching costs.

- <u>Some consumers may prefer not to change their mortgage contract and thus remain with their existing local provider.</u> As such, many consumers fail to look cross-border. Non-financial factors such as the location of the mortgage lender, the attachment to the local provider and the convenience of different distribution channels can all factor into a consumers eventual decision. Although important for banking products as a whole, these non-financial factors may be less important when consumers choose their mortgage lender. For example, in the UK, two thirds of borrowers questioned cited the 'most competitive rate' as the key factor for their decision[64]. It should, however, be acknowledged that the pattern differs amongst EU Member States. Finally, consumers may also be deterred from shopping around in another Member State due to the exchange rate risks which they may occur (i.e. consumers from a Member State outside the euro area may be reluctant to take out a mortgage in euro from a mortgage lender inside the euro area because of the additional risks it entails.)

- <u>Consumers may face high switching costs.</u> In some cases, consumers are not actually able to exit their mortgage contract due to restrictions on their possibilities to prepay either in terms of time or conditions[65]. In other cases, the high costs of switching[66] or entering into a new mortgage contract[67] may outweigh the benefits[68].

The level of these costs is influenced by several factors including price transparency and the level of bundling and tying.

64 *The UK Mortgage Market: Taking a Longer-Term View – Interim Report – Information, Incentives and Pricing*, David Miles, December 2003, p. 39. Statistics based on survey by NOP/Mintel 2003.

65 See for more information Annex 3, Section 2. (early repayment).

66 For example, early repayment charges and administrative costs such as the costs of changing the standing order for mortgage payments.

67 For example, search costs and the administrative costs such as getting a new property valuation, providing the relevant documents to the new mortgage lender, re-registering the property in a mortgage register, or notary fees.

68 See for example Annex 3, Sections 1.1. (pre-contractual information), 2. (early repayment), 3. (product tying) and 4. (credit registers).

- Consumers willing to switch mortgage lenders may be unable to obtain the relevant information to make accurate comparisons due to information asymmetries[69]. A key factor in promoting customer mobility is price transparency. To be able to evaluate thoroughly the different offers, the consumer should be fully aware of the different costs. This is particularly difficult for mortgage credit, for various reasons. Not only are mortgage products complex and the information available is often presented in complex technical and financial terms but also the pricing structure of products may not necessarily provide accurate signals.

- Tying[70] and bundling[71] can impede transparency thus hindering price comparisons, restricting customer mobility and weakening competition[72]. A recent inquiry by the Commission[73] found significant levels of current account tying in the European mortgage market. The incidence of tying life insurance to a mortgage credit or the payment of a salary into a current account was less common[74]. Tying not only has implications for customer mobility but can also reduce price and product competition in the markets for the tied and tying product and discourage the entry of new players, particularly those financial service providers specialising in the tied product.

4.5. Summary

The specific problems in European mortgage markets which have been identified as a result of the extensive consultative process are outlined in detail in Annex 3. The following table summarises the specific problems as described in Annex 3 and explains how they contribute to the general problems outlined above.

This table illustrates the relative importance of the different problems and confirms the importance of removing obstacles to cross-border activity by mortgage lenders.

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69 See for example Annex 3, Section 1.1. (pre-contractual information).

70 Tying occurs when two or more products are sold together in a package and at least one of these products is not sold separately. Cf. footnote 17, p. 59.

71 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). Cf. footnote 17, p. 59; and *Interim report II: current accounts and related services*, European Commission, 17.7.2006, p. 96.

72 Cf. footnote 17, p. 59.

73 Cf. footnote 17, p. 61.

74 Cf. footnote 17, p. 62; and *Interim report II: current accounts and related services*, European Commission, 17.7.2006, p. 109.

Table 1: General and specific problems

Specific problems (drivers and causes of general problems) / General problems	Obstacles to cross-border activity by mortgage lenders	Limited product diversity	Low consumer confidence	Restricted customer mobility
Pre-contractual information: • insufficient information • non-comparability of information • provision of information at different times • lack of credible monitoring and enforcement of information requirements for the Code of Conduct on home loans	X		X	X
Financial education • insufficient levels of financial literacy			X	
Product suitability • insufficient or incorrect assessment of creditworthiness • sub-optimal advice			X	
Early repayment: • different rules on when and under what circumstances consumers can repay early • different rules on the compensation chargeable in the event of early repayment	X	X	X	X
Product tying	X			X
Credit registers: • restricted access to credit registers • high cost of obtaining credit data • incomplete reporting	X			X
Property valuation: • lack of reliable valuation standards (lack of common valuation principles, lack of common valuation methodologies, lack of common standards for the professional qualification of property valuers) • difficulties in using the valuation report	X			
Long forced sales procedures	X			
Land registers: • problems with the accessibility of land registers • high cost and long duration of land registration procedures • lack of completeness of land register due to existence of hidden charges	X			X
Applicable law: • Uncertainty about the law applicable to mortgage contracts	X		X	
Interest rate restrictions: • interest rate caps (absolute and variability) • laws against compound interest	X	X		
Mortgage funding (covered bonds): • non-existent legal framework in some Member States • collateral instrument limitations	X	X		
Mortgage funding (residential mortgage backed securities): • diversity and fragmentation of national securitisation frameworks • limits for UCITS with regard to investments in residential mortgage backed securities of single residential mortgage backed securities issuer (Article 22 of UCITS Directive)	X			
Mortgage funding (transferability of mortgage loan portfolios): • consent or notification of the borrower for assignment of the claim • requirement of registration for changes to beneficiary of the collateral	X	X		
Mortgage funding (reporting): • different levels of reporting across the EU • lack of consistency in definitions across the EU	X	X		

General problems Specific problems (drivers and causes of general problems)	Obstacles to cross-border activity by mortgage lenders	Limited product diversity	Low consumer confidence	Restricted customer mobility
Mortgage funding (data protection): • uncertainty of interpretation of definition of 'personal data' in the Data Protection Directive • requirement of borrower's consent as the legal basis for the processing of personal data	X			
Mortgage funding (Basel II): • differences in interpretation and application of the Capital Requirements Directive across jurisdictions • need for clarity regarding the sunset clause for eligibility of RMBS tranches as cover assets for covered bonds	X			
Lack of standardised, comparable house price indices across the EU	X			
Obligation to be credit institution: • requirement in some countries to become a credit institution in order to engage in mortgage lending • requirement in some countries to become a credit institution in order to engage in servicing	X	X		

5. THE CASE FOR ACTION AT THE EU LEVEL

According to Article 3 of the EC Treaty, an internal market is characterised by the abolition of obstacles to the free movement of goods, persons, services, and capital. Article 14 further states that the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty. Any legislative proposal is likely to be based on Articles 47(2) and 95 of the EC Treaty.

As Section 4 illustrates, the single market for residential mortgages is far from completion as obstacles of different kinds exist. These obstacles severely restrict the level of cross-border mortgage credit activity on the supply and demand sides, reducing competition and choice in the market. As a result, credit providers may be less efficient than they could be and borrowers face less competitive offers, a more limited product choice and some categories of borrowers may be marginalised or even excluded from this market.

The economic cost of having no single market for residential mortgage credit has been studied on behalf of the Commission by UK consultant London Economics. The study[75] predicts that while partial and gradual integration may occur to some extent without intervention at EU level, such intervention would have the potential to enhance integration further, leading to greater competition and product completeness. It estimates that over a period of ten years (2005–2015), the integration of EU mortgage credit markets could raise EU GDP by 0.7% and private consumption by 0.5%. The net present value of all costs and benefits of new initiatives are estimated by the London Economics study over a ten year period (2005–2015) to be EUR 94.6 billion or 0.9% of EU GDP in 2005. Other studies[76] have also concluded that

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[75] Cf. footnote 18, p. 5.

[76] See for example, *Study on the Financial Integration of European Mortgage Markets*, Mercer Oliver Wyman and the European Mortgage Federation, October 2003, p. 5; *Risk and Funding in European Residential Mortgages*, Mercer Oliver Wyman and the Mortgage Insurance Trade Association, April 2005, p. 5.

there are benefits to be achieved through the integration of EU mortgage markets, with one estimating that the benefits of improving the efficiency and completeness of EU mortgage markets per annum to be equivalent to 0.3–0.6% of EU residential mortgage balances or 0.12–0.24% of EU GDP in 2003[77].

<u>Understanding the results of different studies on the benefits of integration</u>

Although the results of the two main studies[78] on the costs and benefits of the integration of EU mortgage markets differ, they both show a strong benefit and are broadly comparable. They do not provide identical results for the following reasons: different methodologies; different statistical data (adjusted prices vs. non-adjusted prices); different assumptions; publication on different dates (2003 vs. 2005); and different time horizons (benefits per annum vs. accumulated benefits over a ten year period).

The 2003 ***Study on the Financial Integration of European Mortgage Markets***[79] **by Mercer Oliver Wyman and the European Mortgage Federation** calculates the benefits from mortgage markets as estimated costs/benefits for the consumer measured in terms of a percentage per year of current outstanding lending in the EU. The benefits identified represent the direct benefits to mortgage borrowers and lenders. Knock-on benefits to other parts of the financial sector or economy in general are not included. While stating that tax differences can be a barrier to integration, the price analysis does not include government or separate subsidised loans. These percentages are then converted into a percentage of GDP based on the assumption that the current outstanding residential mortgages roughly equal 40% of GDP. The benefits are calculated in two parts:

(1) Potential benefits from improved efficiency: 15–30 basis points per year of current outstanding lending or 0.06–0.12% of GDP in 2003;

(2) Potential benefits from improved completeness: 15–30 basis points per year of current outstanding lending or 0.06–0.12% of GDP in 2003.

The 2005 study, ***The Costs and Benefits of Integration of EU Mortgage Markets***[80] **by London Economics**, estimates that a package of 17 proposed measures to integrate EU mortgage markets would only have small effects in the short run but over a ten year period (2005–2015), would increase EU consumption by 0.5% and GDP by 0.7%. The net present value of all costs and benefits of new initiatives are estimated by the London Economics study over a ten year period (2005–2015) to be EUR 94.6 billion or 0.9% of EU GDP in 2005. The study assumed that there are no distortions in tax systems between the consumption of housing and non-housing goods or between foreign and domestic lenders while acknowledging that such distortions exist and would have an effect on the magnitude of the estimated benefits[81].

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77 *Study on the Financial Integration of European Mortgage Markets*, Mercer Oliver Wyman and the European Mortgage Federation, October 2003, p. 5.
78 Cf. footnote 18, p. 5 and footnote 77, p. 5.
79 Cf. footnote 77.
80 Cf. footnote 18.
81 Cf. footnote 18, p. 20.

In conclusion, the former study calculates an annual GDP increase for any given year whereas the latter study calculates the benefit over a ten year period and expresses it as a rate relative to the base year, which is taken as the first year of the ten year period.

Some of the more intangible factors to the cross-border provision of mortgage credit, such as language, distance, consumer preferences, or mortgage lender business strategies, cannot easily be addressed by the EU. 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 Member State can be addressed by appropriate EU policy initiatives.

Whilst some of the problems identified can also raise the cost of mortgage lending in a purely domestic case, these costs are exacerbated for mortgage lenders seeking to engage on cross-border activity and can deter new entrants thereby restricting competition. Although some economic costs will undoubtedly remain – there are always costs for engaging in new business – the extent to which these costs are higher than those for domestic providers can be minimised.

This report will further present a range of policy options to address the problems described above and will carefully assess whether EU action is most appropriate to address the problems identified[82].

6. POLICY OBJECTIVES

Integration of Europe's mortgage markets can take place in a variety of ways. It may be:

- demand driven by consumers actively seeking offers cross-border (for example, via telephone or the Internet);

- supply driven by European mortgage lenders offering their products cross-border directly or indirectly through local ownership (branches, subsidiaries, mergers and acquisitions) or intermediaries;

- funding driven through the development of pan-EU mortgage funding markets, for example, through secondary market trading in mortgage loans or portfolios.

While there is a small but increasing segment of the European population which is active cross-border, indications are that it is likely to remain relatively small in the short to medium term[83]. Consequently, for the near future integration will be predominately driven through cross-border activity by mortgage lenders on both the lending and the funding side.

While European mortgage markets are generally considered to be relatively competitive and efficient at the national level, studies[84] show that gains from enhanced competition and efficiency of mortgage markets could bring benefits to the wider European economy as well as to mortgage lenders and consumers. The development of a single market for mortgage credit would increase competition, be it cross-border and/or domestic, thereby improving

[82] See Annex 3 for further information and analysis.
[83] See Section 3.3 and Annex 1.
[84] See for example, footnote 18, p. 5 and footnote 77, p. 5.

efficiency and enabling the supply of a wider range of products, leading to lower prices and more choice for the consumer.

In this context, the objectives are fourfold.

- To facilitate the cross-border supply and funding of mortgage credit by removing the barriers and reducing the costs of engaging in cross-border activity in order to ensure open markets and strong competition.

- To increase the diversity of products that meet consumers' needs by removing barriers to the distribution and sale of products, including innovative and new products across Europe.

- To improve consumer confidence by ensuring that consumers are empowered to make their own decisions and benefit from a high level of protection.

- To facilitate customer mobility by ensuring that consumers wishing to change mortgage lenders are not prevented or dissuaded from doing so by the presence of either legal or unjustifiable economic barriers.

Simultaneously achieving these objectives is not without its difficulties. Reconciling efforts to improve product diversity with policies to facilitate customer mobility and promote consumer confidence, for example, by ensuring an adequate level of protection, will present particularly difficult policy challenges.

The specific objectives of individual measures are described in detail in Annex 3. The following table summarises the general and specific problems and the related objectives.

Table 2: Problems and objectives

Specific problems	Specific objectives	General objectives			
		Cross-border activity	**Product diversity**	**Consumer confidence**	**Customer mobility**
Pre-contractual information: • insufficient information • non-comparability of information • provision of information at different times • lack of credible monitoring and enforcement of information requirements	• Ensure that consumers are provided with correct, complete and understandable information to enable them to assess the implications of the product and take a decision. • Ensure that the information provided is comparable across the EU. • Ensure that the information provided is at the right moment for consumers to be able to compare the offers available on the market. • Ensure that mortgage lenders operating cross-border do not need to comply with heterogeneous sets of information requirements.	X		X	X
Financial education • insufficient levels of financial literacy	• Ensure that consumers have sufficient financial literacy to able to understand the information provided to them with regard to mortgage products.			X	
Product suitability • insufficient or incorrect assessment of creditworthiness • sub-optimal advice	• Ensure that mortgage lenders, and intermediaries where appropriate, sufficiently assess the creditworthiness of a borrower. • Ensure that consumers have access to objective advice which is based on the profile of the customer and commensurate with the complexity of the products and the risks involved.			X	

Specific problems	Specific objectives	General objectives			
		Cross-border activity	Product diversity	Consumer confidence	Customer mobility
Early repayment: • different rules on when and under what circumstances consumers can repay early • different rules on the compensation chargeable in the event of early repayment	• Ensure that consumers have an option to repay early at a fair and objective price. • Ensure that consumers are not locked into their mortgage contract over the long term and in unforeseen circumstances. • Ensure that mortgage lenders are able to offer their products across the EU.	X	X	X	X
Product tying	• Ensure that product tying does not inhibit the free movement of services throughout the European Union.	X			X
Credit registers: • unfair or discriminatory access to credit registers • incomplete credit information	• Ensure non-discriminatory access to credit registers. • Encourage the provision of more complete information.	X			X
Property valuation: • lack of reliable valuation standards (lack of common valuation principles, lack of common valuation methodologies, lack of common standards for the professional qualification of property valuers) • difficulties in using the valuation report	• Remove the obstacles to the use of foreign valuation reports. • Promote the development and use of reliable valuation standards.	X			
Long forced sales procedures	• Encourage the reduction of the average duration of forced sales procedures.	X			
Land registers: • problems with the accessibility of land registers • high cost and long duration of land registration procedures • lack of completeness	• Ensure non-discriminatory access to land registers. • Encourage the transparency and efficiency of land registers.	X			X
Applicable law: • uncertainty about the law applicable to mortgage contracts	• Clarify which law applies to mortgage contracts involving the laws of different countries.	X		X	
Interest rate restrictions: • interest rate caps (absolute and variability) • laws against compound interest	• Assess the need for and the justification of interest rate restrictions taking into account specifically consumer protection.	X	X		
Mortgage funding (covered bonds): • non-existent legal framework in some Member States • collateral instrument limitations	• Facilitate the development of a wide range of mortgage funding instruments. • Ensure the acceptance of mortgage loans which are secured by mortgages on properties located in other EU jurisdictions as eligible assets in cover pools without endangering the high credit standards in covered bond issuance frameworks.	X	X		
Mortgage funding (residential mortgage backed securities): • diversity and fragmentation of national securitisation frameworks • limits for UCITS with regard to investments in residential mortgage backed securities of single residential mortgage backed securities issuer (Article 22 of UCITS Directive)	• Facilitate the development of a wide range of mortgage funding instruments by removing the barriers to the use of domestic and cross-border securitisation by mortgage lenders. • Ensure that investors in residential mortgage backed securities do not face unnecessary limitations without compromising investor protection.	X			

Specific problems	Specific objectives	General objectives			
		Cross-border activity	Product diversity	Consumer confidence	Customer mobility
Mortgage funding (transferability of mortgage loan portfolios): • consent or notification of the borrower for assignment of the claim • requirement of registration for changes to beneficiary of the collateral	• Facilitate the transfer of mortgage loan portfolios (without compromising on necessary consumer protection rules and without questioning existing national collateral forms where registration required). • Remove unnecessary costs for the transfer of mortgage loan portfolios.	X	X		
Mortgage funding (reporting): • different levels of reporting across the EU • lack of consistency in definitions across the EU	• Promote the development of reporting standards including standardised definitions for capital market mortgage funding products to enhance their marketability and pricing without compromising on data protection issues.	X			
Mortgage funding (data protection): • definition of 'personal data' • requirement of borrower's consent as the legal basis for the processing of personal data	• Enable mortgage lenders to provide third parties (e.g. investors, other lenders and servicers) when necessary with personal data on the borrower in order to enable them to make an informed decision. • Ensure mortgage lenders do not face unnecessary costs while providing data to investors, while complying with data protection laws and without compromising a borrowers' fundamental right of privacy.	X			
Mortgage funding (Basel II): • differences in interpretation and application of the Capital Requirements Directive across jurisdictions • need for clarity regarding the sunset clause for eligibility of RMBS tranches as cover assets for covered bonds	• Promote a consistent interpretation and application of the Capital Requirements Directive across Member States. • Review the eligibility of residential mortgage backed securities tranches as cover assets for covered bonds without compromising the low risk characteristics of a covered bond.	X			
Lack of standardised, comparable house price indices across the EU	• Promote the development of house price indices to assist in the provision of more accurate valuation information, to increase the efficiency of collateral in all forms of capital market funding and to help to manage the exposure to property price risk through the development of derivative markets.	X			
Obligation to be a credit institution: • requirement in some countries to become a credit institution in order to engage in mortgage lending • requirement in some countries to become a credit institution in order to engage in servicing	• Facilitate cross-border activity by mortgage lenders who are not credit institutions without compromising financial stability and effective supervision. • Facilitate the use of servicers as a means of accessing new markets without compromising financial stability and effective supervision.	X	X		

7. ASSESSING AND COMPARING POLICY OPTIONS

7.1. Choosing the optimal policy mix

The description of the problems and objectives has illustrated the complexity in developing an effective and coherent mortgage credit policy which brings net benefits to stakeholders as a whole.

In order to establish the most appropriate policy response to meet the objectives set, a comprehensive analysis and comparison of different policy options has been conducted. For each problem identified, a mix of policy options from the following range has been considered:

- do nothing;
- develop a 'scoreboard';
- issue guidelines;
- publish a Recommendation;
- encourage self-regulation;
- enforce existing EU legislation;
- present new legislation.

In some areas, it is clear that further analysis needs to be undertaken before any meaningful policy options can be proposed. Some options have been dismissed as being unrealistic or obviously cost ineffective. For all credible options, the impact was carefully and thoroughly assessed, taking into consideration the positive/negative and direct/indirect effects. The main criterion used to compare the options is the effectiveness of each option in terms of achieving the objectives set. In addition, other aspects such as the efficiency of each option and their impacts on different stakeholder groups were taken into account where sensible at this stage of the review. This comprehensive analysis of the policy options, together with its results, is contained in Annex 3. On the basis of this assessment, ineffective policy options have been dismissed. The most effective policy options (preferred policy options) are listed below in Table 3.

Table 3 illustrates to what extent the preferred policy options help to meet the objectives set out in Section 5. The general objectives are stated in the four columns on the right hand side. The general objectives which the specific objectives aim to address are shaded in grey. The extent to which the objectives are met is illustrated by different symbols, for example, ++ means strongly positive and + means positive. In a few instances, for example for areas where it has been established that further analysis is required (e.g. residential mortgage backed securities) or subjects where a separate initiative is currently ongoing (e.g. applicable law) no analysis of the impact has been carried out. In these cases, n.a. is indicated (not applicable).

In some cases, multiple preferred policy options have been presented for two reasons. First, several options are presented when different options could be equally effective (indicated as 'alternative options'). For example, for the specific issue of 'pre-contractual information' two options are presented: a modification of the Code of Conduct or the development of binding legislation. Although the table suggests that legislation would be more effective in terms of achieving the set objectives, whether the cost of implementing legislation outweighs the benefits is still to be assessed. Consequently, a more in-depth quantitative impact assessment will be required to establish which of the two preferred options is the most efficient. Second, for some issues several complementary options are presented (indicated as 'complementary options'). In such cases, the cumulative impact of these options would be more effective than if they were undertaken separately.

Table 3: Effectiveness of preferred policy options in achieving the general objectives

Notes: (1) Key: ++ = strongly positive; + = positive; – – = strongly negative; – = negative; ≈ = neutral; ? = uncertain; n.a. = not applicable. (2) The options numbers listed, e.g. Option 2, refer to the option numbers in Annex 3, where a full list of the options considered is available.

Preferred policy options[85]	Cross-border activity	Product diversity	Consumer confidence	Customer mobility
Pre-contractual information: information requirements (alternative options)				
Modification of the existing Code of Conduct (Option 2)	≈	≈	+	≈/+
Legislation (Option 3)	+	≈	+/++	+
Pre-contractual information: Annual Percentage Rate of Charge				
Legislation (Option 3)	+	≈	+/++	+
Financial education				
Communication on financial education	≈/+	≈/+	+	+
Product suitability (alternative options)				
Legislation (creditworthiness) (Option 4.1)	≈	–/≈	+/++	≈
Legislation (optional advice according to certain principles) (Option 4.3)	≈	≈	+/++	≈
Early repayment (alternative options)				
Legislation: liberalisation of early repayment regimes (contractual option) but with a right to early repayment in certain circumstances and with liberalisation of early repayment compensation regimes (fair and objective compensation) (Option 3.2)	?	+/++	?	?
Legislation: introduce a compulsory right to early repayment and liberalisation of early repayment compensation regimes (fair and objective compensation) (Option 3.3)	+	– –/–	+/++	≈/+
Product tying (alternative/complementary options)				
Self-regulation (Option 2)	≈/+	≈	≈	≈/+
Legislation (Option 3)	+	≈	≈/+	+/++
Credit registers (complementary options)				
Enforcement of existing EU rules (Option 2)	≈/+	≈	≈	≈/+
Self-regulation (Option 3)	+	≈	≈	≈/+
Legislation (Option 4)	+/++	≈	≈/+	+
Property valuation				
Recommendation (Option 3)	+	≈	≈	≈
Forced sales procedures (complementary options)				
Scoreboard(Option 2)	≈/+	≈	≈	≈
Recommendation(Option 3)	≈/+	≈	≈	≈
Land registration (complementary options)				
Scoreboard (Option 2)	≈/+	≈	≈	≈/+
Recommendation (Option 3)	≈/+	≈	≈	+

85 Option numbers refer to the option numbering in Annex 3.

Preferred policy options[85]	**Cross-border activity**	**Product diversity**	**Consumer confidence**	**Customer mobility**
Applicable law				
Regulation on the law applicable to contractual obligations[86]	n.a.	n.a.	n.a.	n.a.
Usury rules and interest rate variation				
Further analysis (Option 1)	n.a.	n.a.	n.a.	n.a.
Covered bonds: facilitate the development of a wide range of funding instruments				
Do nothing (Option 1)	+	+	≈	≈
Covered bonds: ensure the acceptance of mortgages on non-domestic property as cover assets				
Enforce existing legislation (Option 2)	?	?	≈	≈
Residential mortgage backed securities: diversity and fragmentation of national securitisation frameworks				
Further research on the fragmentation of EU securitisation frameworks (Option 1)	n.a.	n.a.	n.a.	n.a.
Residential mortgage backed securities: limits for UCITS with regard to investments in residential mortgage backed securities of single residential mortgage backed securities issuer (Article 22 of UCITS Directive)				
Do nothing (Option 2)	≈	≈	≈	≈
Transferability of mortgage loan portfolios to third parties				
Further analysis (Option 1)	n.a.	n.a.	n.a.	n.a.
Reporting				
Self-regulation(Option 2)	+	+	≈	≈
Data protection				
Article 29 Data Protection Working Party (Option 1)	≈/+	≈/+	≈	≈
Basel II				
Continue Commission process for further convergence of the Capital Requirements Directive (Option 1)	+	≈	≈	≈
House price indices				
Continue Eurostat project (Option 1)	+	≈/+	≈	≈
Non-credit institutions and servicers				
Further analysis (Option 1)	n.a.	n.a.	n.a.	n.a.

As is illustrated by Table 3, it is difficult to address all dimensions with a single measure. The impact assessment has therefore focused on the development of the most optimal package to achieve the objectives set out in the previous section.

The package described in Table 3 presents a range of preferred policy options which would facilitate the **cross-border operation of mortgage lenders on both primary and secondary mortgages markets**. Taking into account the extent of the problem and the need for a proportionate policy response, primarily non-legislative measures have been proposed (with the notable exception of credit registers and, more significantly, early repayment). This is

86 The proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I) - COM(2005) 650 - is being discussed in the European Parliament and Council.

consistent with the feedback received in the consultative process[87]. With the exception of the options proposed for credit registers and early repayment (depending on the legislative approach chosen), no single policy option identified so far can be said to have a profound impact on cross-border activity; the cumulative effect of which would however contribute to increased cross-border activity and consequently **product diversity**.

The package also identifies four key areas for improving **consumer confidence and customer mobility**: pre-contractual information, product suitability, early repayment, and product tying. In general, the legislative options appear to be more effective than self-regulation in achieving the objectives set. The principle reason for this is doubts about the effectiveness – in terms of subscription to, adherence to and enforcement of – self-regulation and/or recommendations in the field of mortgage credit. If it could be ensured that all mortgage lenders subscribed to and adhered to self-regulatory measures and/or Member States fully implemented and enforced Recommendations, the effectiveness of measures would be positively enhanced.

It is important to underline that the measures proposed should not be seen in isolation but rather as a package. The close relationship between the different issues identified and the need for a concerted approach was recognised by the Forum Group on Mortgage Credit which stated: 'The Commission is asked to review these recommendations as a complete package, as action only on any individual recommendation is considered to be incapable of delivering further integration of this market'[88]. This approach is consistent with the results of the impact assessment.

While some measures, such as pre-contractual information and product suitability focus on one objective (e.g. consumer confidence), others, such as land registration, property valuation and forced sales procedures, focus on another objective (e.g. facilitating cross-border activity by mortgage lenders). Taken in isolation, any one individual measure may appear unbalanced veering towards one individual objective but viewed together, as a package, the measures present a balanced approach, taking into account the impact on all stakeholders. Viewed from this perspective, no one individual measure is likely to bring the benefits of integration alone. Some will make it easier for mortgage lenders to engage in cross-border activity or offer their products in another Member States. Others will make consumers feel more confident about engaging in shopping around or make it easier to seek out different mortgage credit providers. In addition, the measures suggested to achieve a certain objective might bring other positive side-effects for the economy. For instance, the measures on land registration and forced sales procedures, which are designed to facilitate cross-border activity by mortgage lenders, could improve the efficiency of public services in general and complement eGovernment plans, thus delivering further benefits to market participants. It is therefore the cumulative effect of a series of complementary measures, each focusing on taking a step forward to achieving one of the objectives set, that appears to be the best way forward.

The issue of **early repayment** however deserves particular attention. The impact assessment concludes that legislative measures would be most effective in addressing the problems caused by the existence of different early repayment regimes in the EU. However, in terms of different legislative options, the impact assessment highlights two preferred options (see Table 3 above). The different preferred options are <u>alternatives</u> and illustrate a clear policy

[87] See Annex 2 for further information on the feedback received in the consultative process.
[88] Cf. footnote 32.

choice to be made between improving consumer confidence and mobility on the one hand and enhancing product diversity on the other hand. Consequently, the different options have radically different impacts on the different stakeholder groups. It should be underlined that early repayment is the only issue which directly effects product diversity. Both options offer some benefits to mortgage lenders seeking to operate cross-border. A detailed quantitative impact study would be required to fully assess the impact of these different options on the different stakeholders before a final decision could be taken.

In conclusion, the overall impact of the package is expected to be positive. It should facilitate cross-border activity and improve product diversity, while at the same time enabling customer mobility and raising consumer confidence. A detailed quantitative impact study would however be required to fully assess the size of the net positive impact of the package.

7.2. Impact of the proposed policy mix on stakeholders

The package described above will impact on stakeholders in different ways. The impact of the package is presented in Table 4. A complete overview of the impact of all policy options, including those which were rejected and thus are not included in Table 4, is available in Annex 3.

The first column of Table 4 gives the preferred policy option and the remaining columns contain the impact on the different stakeholder groups. The impact is described by different symbols, for example, ++ means strongly positive impact, + means positive impact, and ≈ implies neutral impact. The table also shows whether the impact will be a direct impact (D) or an indirect impact (I). As with the previous table, for areas where it has been established that further analysis is required (e.g. residential mortgage backed securities) or subjects where a separate initiative is currently ongoing (e.g. applicable law) no analysis of the impact has been carried out. In these cases, n.a. is indicated (not applicable).

For example, modifying the existing Code of Conduct on pre-contractual information on mortgage lenders would lead to a direct (D) negative impact (–) by increasing (↑) costs for mortgage lenders to implement the Code.

7.2.1. Impact on consumers

In analysing the overall impact of the package on consumers both direct and indirect impacts need to be considered. While the net impacts are difficult to assess in quantitative terms, the overall benefits are seen to be positive.

7.2.1.1. Indirect impacts

Many of the measures to improve the efficiency and competitiveness of cross-border mortgage lending – both on primary and secondary markets – would lead to improved product diversity and, potentially, lower prices for consumers. Various studies argue that these 'indirect' effects are likely to bring the greatest benefits for consumers[89].

Ensuring that consumers have access to products which meet the full range of their diverse needs by increasing product diversity would have a significant positive impact on EU mortgage markets. Most analysts agree that the greatest benefits to EU mortgage market

[89] See for example, footnote 18, pp. 5–6 and footnote 77, p. 5.

integration could be obtained by increasing product diversity (i.e. in terms of the products available for existing borrowers as well as broadening the range of borrowers served). One study[90] estimates that removing the barriers to product availability could increase EU consumption by 0.4% and EU GDP by 0.6% over the next ten years. Another study[91] estimates that the benefits from improved product diversity could lead to a 10% expansion in the market size by enabling new borrowers to access mortgage credit and 25% 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. The proposed measures could potentially facilitate lending to borrowers with impaired credit histories or who are unable to prove their income (e.g. sub-prime borrowers) as well facilitate access for certain groups of consumers, such as the elderly (if they wish) to the equity contained in their home. It is important to ensure that consumers, in particular vulnerable consumers such as those mentioned, are part of the formal economy and do not turn to other, potentially harmful sources of credit. The extent to which certain groups of consumers, e.g. sub-prime borrowers, benefit from the availability of a wider range of products is however closely related to social policies in Member States. In countries with rental subsidies, for example, the demand for access to mortgage credit may be suppressed to some extent[92].

In terms of lower prices, the benefits arising from increased efficiency of mortgage lenders and the greater competitiveness of EU mortgage markets could reduce mortgage interest rates by 47 basis points by 2015 (relative to the baseline case with no integration), reducing the interest payable on a EUR 100 000 mortgage loan by EUR 470 per year[93]. Increased customer mobility, as a result of several policy measures to improve the quality and comparability of pre-contractual information, the access to and appropriateness of credit data, and to prevent product tying should also facilitate the switching of mortgage credit providers by lowering search costs. These initiatives should create a more competitive environment and generally lead to further price reductions. The benefits to consumers would not be equally distributed throughout the EU; for example, consumers in countries, where tying is prevalent, such as Slovakia, Portugal, Latvia, and Hungary, would have the most potential for benefits from measures preventing tying, whereas consumers in countries where there is more limited tying, such as Austria or Ireland, would feel less of an impact.

7.2.1.2. Direct impacts

Increasing product diversity is not without its risks. Faced with an ever wider range of products to choose from, it is important to recognise that many consumers may feel overwhelmed by the choice available and might end up choosing an inappropriate product. Taking these concerns into account, the package of measures seeks to ensure that consumer confidence is maintained or even improved by making sure that adequate safeguards are in place to ensure that consumers purchase an appropriate mortgage credit product for their needs. Adopting the preferred policy options would see this done in three main ways. First, it would ensure that consumers receive the appropriate comparable information to compare products and make a choice. This would also ensure that increased product diversity does not necessarily make it harder for consumers to compare different mortgage offers. Second, it would ensure that consumers are provided with a selection of appropriate products to choose

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90 Cf. footnote 18, p. 6.
91 Cf. footnote 77, p. 78.
92 Cf. footnote 77, p. 78.
93 Cf. footnote 18, p. 5.

from by the mortgage lender and/or intermediary (i.e. by responsible lending policies such as improving access to credit registers, creditworthiness assessments, etc.). Finally, the measures would ensure that those consumers who would like to receive a recommendation for a particular product can access it (i.e. access to advice) and that when advice is given it is of a high-quality. By choosing the most appropriate product for their needs, the risk of consumers being unable to keep up repayments and losing their home would be minimised. This policy cannot however entirely prevent overindebtedness or foreclosures on properties as there will always be cases where consumers fail to keep up with payment obligations because of unexpected life events.

While there is a small risk that such 'responsible lending policies' could potentially lead to the exclusion of a small number of, mainly 'sub-prime' borrowers who are currently able to purchase mortgage credit, but might not be able to do so in the future, such steps are deemed necessary to prevent irresponsible lending practices and risks to both institutional and financial stability in the future. These measures will also translate into higher costs for mortgage lenders and therefore have a negative impact on the price of mortgage credit.

7.2.2. Impact on mortgage lenders

For mortgage lenders there are both costs and benefits in the implementation of the package.

Benefits can be realised through a more efficient mortgage lending process which would lead to lower costs: reduced costs for refinancing costs, land registrations and credit information access. Some studies estimate that facilitating cross-border access for mortgage lenders by improving the efficiency of cross-border activity could bring benefits of between 0.15% and 0.30% of residential mortgage balances or 0.06% to 0.12% of EU GDP per annum[94]. Such gains could be achieved by reductions in servicing, distribution, origination and funding costs[95]. Mortgage lenders are also likely to benefit from enhanced transparency in several areas (credit registers, land registers, forced sales procedures, house price indices) which should enable them to more accurately price their products to risks. In addition, the ability of mortgage lenders to access other markets and engage in cross-border activity would clearly be enhanced, offering opportunities in terms of new business.

In terms of the distribution of the benefits amongst mortgage lenders, mortgage lenders operating both domestically and cross-border have the potential for benefits. However, lenders intending to operate or already operating cross-border would have the most to gain in terms of market positioning compared to domestically orientated mortgage providers. While larger mortgage lenders are perhaps more likely to engage in cross-border activity, small or medium-sized service providers, especially those specialising in certain niche products which are not available on all mortgage markets or providing services in border regions, could also benefit from the package and increase their cross-border activity.

While the package offers distinct benefits for mortgage lenders, the cost of implementing these measures should not be underestimated. One study estimates that the cost of integration at EUR 2.4 billion on a one-off basis and an annual flow cost of EUR 2.4 billion (in 2005 prices)[96]. For potential legislative measures such as implementing measures relating to pre-contractual information and the Annual Percentage Rate of Charge, back-office procedures

94 Cf. footnote 77, pp. 6, 77 and 80.
95 Cf. footnote 77, pp. 6 and 80.
96 Cf. footnote 18, p. 104.

will have to be amended and compliance ensured. The costs of introducing a European Standardised Information Sheet will however depend on the extent to which the mortgage lender has already applied the existing Code of Conduct, although some changes in terms of content are to be expected. Any measure to prevent product tying would require mortgage lenders in countries where tying is prevalent, such as Slovakia, Portugal, Latvia, and Hungary, to the re-develop their risk assessment models. It should however be emphasised that those measures which bring the highest costs to mortgage lenders in terms of implementation are the same measures which bring the most benefits for consumers.

7.2.3. Impact on investors

In general terms, investors would face a lower risk when investing in mortgage backed products as a result of several factors. First, measures to improve responsible lending, such as those to facilitate creditworthiness checks, would reduce the likelihood of borrower default and consequently, lower the default risk. Second, measures that contribute to enhanced market transparency, such as reporting standards for mortgage funding instruments and house price indices, would facilitate the assessment of the risks connected with the product and enable more accurate comparisons between different mortgage backed investment products. Third, in the event of default, investors would have greater certainty as to the recovery value of their investment. Finally, investors would also be able to benefit from a broader range of investment opportunities as a result of enhanced product diversity both on primary and secondary markets. Those benefits can be reaped not only by EU investors but also by investors from outside Europe investing in European mortgage funding instruments like covered bonds or residential mortgage backed securities, thereby strengthening the role of the Euro as a reserve currency.

7.2.4. Impact on Member States

The distribution of the benefits from integration are unlikely to be distributed evenly between Member States. Countries with less developed mortgage markets, such as Hungary or Slovenia, are expected to benefit more from integration than those with well developed mortgage markets, such as Sweden, the UK or the Netherlands[97].

Although a detailed quantitative impact study would be required to fully assess the administrative burden of the different options on Member States, the type of costs faced can be established. The administrative burden for Member States implementing the preferred policy options fall broadly into two categories: cost in terms of implementing legislation and/or recommendations and costs for compiling data for scoreboards and house price indices.

The level of costs depends on the extent to which Member States already have processes in place. For example, the costs of implementing recommendations to improve the efficiency of forced sales procedures would be minimal in countries such as Finland, which has relatively efficient forced sales procedures. In contrast, countries such as Italy, which has longer forced sales procedures, would face more costs. Although many Member States would also face costs in designing and – possibly – subsidising financial education projects locally, it is probably that Member States would have pursued similar projects anyway. In terms of collecting the relevant data for house price indices, eleven countries[98] are currently

[97] Cf. footnote 18, p. 98.

[98] Cyprus, Finland, Germany, Greece, Italy, Poland, Slovak Republic, Slovenia, Spain, Netherlands and United Kingdom.

participating in the current pilot work with financial support from Eurostat and other Member States are expected to increase cooperation in the future. Consequently, the eventual costs of moving from enhanced cooperation to the formal establishment of a house price index in the future would be relatively small.

The costs of implementing EU legislation would depend on the eventual content of the legislation vis-à-vis the current national legal framework, for example, on pre-contractual information or the Annual Percentage Rate of Charge. It is however likely that all Member States would face some administrative costs as it is unlikely that any eventual proposal would fit the current national situation exactly. Costs to Member States for implementing legislation can however be minimised by choosing the self-regulatory options over the legislative ones. However, as described above, opting for self-regulatory measures involve a trade-off with policy effectiveness, unless subscription and adherence to self-regulation can be ensured with appropriate enforcement mechanisms. If the enforcement mechanisms were potentially run by Member States, costs would also be incurred. A detailed quantitative impact study would be required to fully assess the net impact of self-regulatory measures when compared to legislative options on the different stakeholders before a final decision could be taken.

The level of costs for collecting data for scoreboards on land registration and forced sales procedures also depend on the extent to which Member States already have data collection processes in place. If Member States already have a methodology and collection process in place, these costs could be minimal. If however, no centralised or harmonised data exists, the burden will be larger. For example, in Germany, the applicable statistics are not kept by state agencies on a nationwide basis[99]. These costs to Member States could however eventually be minimised by collecting the data from alternative sources, such as the mortgage lending industry who already publish regular scoreboards based on their own data[100].

7.2.5. Impact on other stakeholder groups

Certain policies will also have impacts on **other stakeholder groups** such as credit intermediaries (positive and negative), independent financial advisers (positive and negative), credit registers (positive and negative), property valuers (negative) and the providers of financial products tied to mortgage credit (positive). In general, the negative impacts arise through the implementation of the proposed policy option. The positive impacts originate from the potential for new business.

No direct impacts on third countries are expected however some indirect effects may ensue. The recent sub-prime crisis in US mortgage markets and the subsequent liquidity problems in the EU, for example, illustrate the impact that mortgage lending policies in one country (the US) can have on other countries in the global economy.

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99 *Additional Comments on the 'Mortgage Credit in the EU Green Paper' by the European Commission*, Response of the Federal Ministry of Justice to the Government Expert Group on Mortgage Credit, August 2006.

100 See for example, scoreboards published by the European Mortgage Federation in *Study on the Efficiency of Mortgage Collateral in the European Union*, European Mortgage Federation, 2007.

Table 4: Impacts of preferred options on stakeholders

Notes: ++ = strongly positive; + = positive; – – = strongly negative; – = negative; ≈ = neutral; ? = uncertain; n.a. = not applicable; D = direct impact; I = indirect impact; ↑ = increase/rise; ↓ = decrease/fall.

Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Pre-contractual information					
Modification of the existing Code of Conduct (Option 2)	+/++ receiving correct, complete and understandable information (D) ≈ information not necessarily comparable (including on annual percentage rate of charge) (D) +/++ receiving information at the right moment (D) ≈/+ ↑ mobility (I)	– ↑ cost for implementing changes to the Code (D) ≈ cost for possibly complying with heterogeneous sets of information requirements (I) –/≈ distorted level playing field (D)	n.a.	≈	Intermediaries: – ↑ cost for implementing changes to the Code (D) ≈ cost for possibly complying with heterogeneous sets of information requirements (I) –/≈ distorted level playing field (D)
Legislation (Option 3)	+/++ receiving correct, complete and understandable information (D) +/++ receiving comparable information (including on annual percentage rate of charge) (D) +/++ receiving information at the right moment (D) + ↑ mobility (I)	? overall costs: => ↑ cost for adapting to and complying with new information requirements) (D) => ↓ cost for complying with heterogeneous sets of information requirements (I) + ↑ level playing field between mortgage lenders (D)	n.a.	–/– – ↑ Cost for introduction/amendment of legislation (D)	Intermediaries: ? overall costs: => ↑ cost for adapting to and complying with new information requirements) (D) => ↓ cost for complying with heterogeneous sets of information requirements (I) + ↑ level playing field (D)

101 Option numbers refer to the option numbering in Annex 3.

Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Financial education					
Communication on financial education	+ purchase a suitable product for their needs (D) + can understand the consequences of their purchasing decisions (D) + may be less likely to default on payments and be subject to foreclosure (D)	– overall costs: mortgage lenders would be encouraged to develop financial education programmes (D); this may not be rewarded by greater customer loyalty; mortgage lenders would still be required to make the necessary information provision on individual products (D); + financially literate consumers may be willing to reward innovation by choosing creative mortgage products ≈/+ reduced risk of default overall	≈/+ reduced risk of default	–/– – Cost for introduction/ roll-out of financial education initiatives (D)	n.a.
Product suitability					
Legislation (creditworthiness) (Option 4.1)	+/++ purchase a suitable product for their needs (D) – ↓ product availability (exclusion of certain groups of consumers) (I) +/++ ↓ foreclosures (I)	– ↑ cost in terms of introducing new processes to assess a consumer's creditworthiness and staff training (D) + ↓ risk of default (I)	+ ↓ risk of default (I)	– –/– ↑ costs for introduction of legislation (D)	Intermediaries : – ↑ cost in terms of introducing new processes to assess a consumer's creditworthiness and staff training (D)
Legislation (optional advice according to certain principles) (Option 4.2)	+/++ purchase a suitable product for their needs (D) +/++ are able to access objective and appropriate advice (D) ? price if advice is not obligatory +/++ ↓ foreclosures (I)	– ↑ cost in terms of introducing new processes, staff training and to cover potential liability (D) + ↓ risk of default (I)	+ ↓ risk of default (I)	– –/– ↑ costs for introduction of legislation (D)	Intermediaries and independent financial advisers: – ↑ cost in terms of introducing new processes, staff training and to cover potential liability (D)

Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Early repayment					
Legislation: liberalisation of early repayment regimes (contractual option) but with a right to early repayment in certain circumstances and with liberalisation of early repayment compensation regimes (fair and objective) (Option 3.2)	+/++ ↑ choice of products (D) For Member States which currently have a right to early repayment: => –/≈ ↓ customer mobility (some consumers will not have a right but those who want it can have it; right in certain circumstances guaranteed but size of effect depends on the cost of early repayment negotiated between the borrower and mortgage lender; also not all customers will want to repay early) (D) => – ↓ consumer confidence (D) For Member States which currently do not have a right to early repayment: => ≈/+ ↑ customer mobility (right in certain circumstances guaranteed but size of effect depends on the cost of early repayment negotiated between the borrower and mortgage lender; also not all customers will want to repay early) (D) => ≈ consumer confidence (D)	+/++ ↑market access (D) +/++ ↑ economies of scale and scope (D) ≈ stability of financial institutions (D)	≈	– ↑ varying levels of cost for amending legislation for Member States (D)	n.a.
Legislation: introduce a compulsory right to early repayment with liberalisation of early repayment compensation regimes (fair and objective) (Option 3.3)	–/– – ↓ choice of products (D) –/– –↑ prices (D) For Member States which currently do not have a ight to early repayment: ≈/+ ↑ mobility (but not all customers will want to repay early) (D) ≈/+ ↑ confidence (D)	+/++ easier market access (D)	– ↓ investment opportunities (I)	– ↑ cost for amending legislation for Member States (some will require more amendments than others) (D)	

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Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Product tying					
Self-regulation (Option 2)	≈/+ freedom to contract financial services with the provider of their choice but some practices may still be remain (D) ≈/+ ↑ potential for increased customer mobility (D) ≈/+ ↓ prices as a result of more competition (new entrants and increased mobility) (I)	? dependent on the level of adherence to the Code: => ≈/+ for new entrants (I) => –/≈ for mortgage lenders who currently tie products but would have to amend their current business strategy (D)	n.a.	≈ (I)	Providers of tied products: ≈/+ for new entrants (I)
Legislation (Option 3)	+/++ freedom to contract financial services with the provider of their choice (D) +/++ ↑ potential for increased customer mobility (D) +/++ ↓ prices as a result of more competition (new entrants and increased mobility) (I)	? dependent on the balance between: => ≈/+ for new entrants (I) => –/≈ for mortgage lenders who currently tie products but would have to amend their current business strategy (D)		– ↑ costs for implementing legislation (D)	Providers of tied products: ≈/+ for new entrants (I)
Credit registers					
Enforcement of existing legislation (Option 2)	≈/+ ↓ prices (I) ≈ on the accuracy of consumer's personal data (I) ≈/+ ↑ customer mobility (I)	≈/+ ↓ information asymmetries (D) ≈/+ accessibility of credit registers (D) ≈ incomplete credit information (D)	n.a.	– ↑ costs for change of legislation on access conditions (if credit registers are publicly owned) (D)	Credit registers: – ↑ costs for amending access conditions (D)
Self-regulation (Option 3)	≈/+ ↓ prices (I) ≈/+ on the accuracy of consumer's personal data (I) ≈/+ ↑ customer mobility (I)	≈/+ ↓ information asymmetries (D) – ↑ costs for engaging in self-regulation (D) + ↑ accessibility of credit registers through indirect access (D) + ↑ complete credit information (D)	n.a.	≈/– ↑ costs for amending framework on credit registers for some Member States (D)	Credit registers: – ↑ costs for engaging in self-regulation (D) + ↑ accessibility of credit registers through indirect access (D) + ↑ complete credit information (D)
Legislation (Option 4)	+ ↓ prices because more risk accurate (I) +/++ on the accuracy of consumer's personal data (I) + ↑ customer mobility (I)	+ ↓ information asymmetries (D) ++ non-discriminatory access of credit registers (D) +/++ more complete credit information (D)	n.a.	– ↑ costs for implementation of legislation (D)	Credit registers: – ↑ costs for changing their access conditions and data collection process (D) – ↑ costs for collecting accurate consumer information (D) ≈/+ potentially ↑ in revenues arising from more credit applications

Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Property valuation					
Self-regulation (Option 2)	≈/+ ↓ prices (I) ≈/+ ↑ product diversity (I)	≈/+ confidence in valuation report they receive (D) ≈ use of valuation reports (D) –/≈ ↑ cost for changing valuation procedures (D)	≈/+ ↑ certainty with regard to the value for mortgage backed investment products (I)	–/≈ ↑ depending on whether Member States decide to amend their legislation in line with the self-regulatory standards (I)	Valuers: –/≈ ↑ cost for complying with valuers' qualifications requirements (D)
Recommendation (Option 3)	≈/+ ↓ prices (I) ≈/+ ↑ product diversity (I)	≈/+ confidence in valuation report they receive (D) ≈/+ use of valuation reports (D) –/≈ ↑ cost for changing valuation procedures (D)	+ more certainty with regard to the value for mortgage backed investment products (I)	– –/– ↑ cost for implementing legislation (D)	Valuers: –/≈ ↑ cost for complying with valuers' qualifications requirements (D)
Forced sales procedures					
Scoreboard (Option 2)	+ ↑ product diversity (I) + ↓ prices (I)	+ ↑ information on efficiency of national foreclosure proceedings (D) ≈ certainty as to recovery of money because existence of different national foreclosure proceedings with varying degrees of efficiency (D)	+ ↑ information on efficiency of national foreclosure proceedings (D) ≈ certainty as to recovery of money because existence of different national foreclosure proceedings with varying degrees of efficiency (D)	– ↑ Cost for compiling data and improvement of national foreclosure procedures (D)	n.a.
Recommendation (Option 3)	+ ↑ product diversity (I) + ↓ prices (I)	+ ↑ certainty as to the recovery of money through increasing efficiency of different national foreclosure proceedings (D)	+ ↑ certainty as to recovery of money through increasing efficiency of different national foreclosure proceedings (D)	– ↑ cost for improvement of national foreclosure procedures (D)	n.a.

Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Land registration					
Scoreboard (Option 2)	≈/+ potential for ↓ prices from increased competition between mortgage lenders (I)	≈/+ ↓ cost for land registration process due to higher efficiency (D) ≈ on-line access to property information across EU on a non-discriminatory basis (D) ≈ certainty as to recovery value because of information on non-registered preferential charges (D)	≈ certainty as to recovery value because of information on non-registered preferential charges (I)	– ↑ cost for compiling and delivering data and eventually for improvement of national land registration procedures (D)	n.a.
Recommendation (Option 3)	≈/+ ↓ cost for land registration process due to higher efficiency (D) ≈/+ ↓ prices (I)	≈/+ ↑ on-line access to property information across EU on a non-discriminatory basis (D) ≈/+ ↓ cost for land registration process due to higher efficiency (D) ≈/+ ↑ certainty as to recovery value because of information on non-registered preferential charges (I)	≈/+ ↑ certainty as to recovery value because of information on non-registered preferential charges	– ↑ Cost for changes to land registration system and procedures (D)	n.a.
Applicable law					
Regulation on the law applicable to contractual obligations	n.a.	n.a.	n.a.	n.a.	n.a.
Usury rules and interest rate variation					
Further analysis (Option 1)	n.a.	n.a.	n.a.	n.a.	n.a.
Covered bonds					
Do nothing (Option 3)	+ ↑ product diversity (I) + ↓ prices (I)	≈/+ ↑ use of covered bonds as alternative funding instrument (D) ≈/+ ↑ use of mortgages on non-domestic property (D)	+ ↑ level of investment into covered bonds for investment funds in Member States with covered bond legislation if fulfilling conditions in Article 22(4) UCITS (I)	– ↑ cost for introduction/amendment of covered bond legislation (D)	n.a.
Enforce existing legislation (Option 2)	≈/+ ↑ product diversity (I) ≈/+ ↓ prices (I)	+ ↑ use of mortgages on non-domestic property (D)	? maintaining high credit standard of covered bond framework (I)	– ↑ cost for amendment of covered bond legislation (D)	n.a.

Preferred option[101]	Consumers	Mortgage lenders	Investors	Member States	Other
Residential mortgage backed securities: diversity and fragmentation of national securitisation frameworks					
Further research on the fragmentation of EU securitisation frameworks (Option 3)	n.a.	n.a.	n.a.	n.a.	n.a.
Residential mortgage backed securities: limits for UCITS with regard to investments in residential mortgage backed securities of single residential mortgage backed securities issuer (Article 22 of UCITS Directive)					
Do nothing (Option 2)	≈	≈	≈	≈	≈
Transferability of mortgage loan portfolios to third parties					
Further analysis (Option 1)	n.a.	n.a.	n.a.	n.a.	n.a.
Reporting					
Self-regulation (Option 2)	+ ↑ product diversity (I) + ↓ prices (I)	+ ↓ funding costs (D) – ↑ reporting costs (D)	++ ↑ transparency regarding financial instruments and cross-border comparability of information (D)	≈	n.a.
Data protection					
Article 29 Data Protection Working Party (Option 1)	≈/+ ↑ product diversity (I) ≈/+ ↓ prices (I) ≈ on the level of data protection (D)	+ ↑ certainty with regard to the definition of 'personal data' (D) + ↓ refinancing costs (I)	+ ↑ access to data (I)	– ↑ costs due to implementation of the opinion of the Data Protection Working Party (D)	n.a.
Basel II					
Continue Commission process for further convergence of the Capital Requirements Directive (Option 1)	+ ↓ prices (I)	+ ↑ level playing field in terms of regulatory capital relief for funding instruments (D)	n.a.	– ↑ costs for amendment of national legislation (D)	n.a.
House price indices					
Continue Eurostat project (Option 1)	+ ↑ product diversity (I) and ↓ prices (I)	+ ↓ refinancing costs through more transparency because of more standardised, reliable data on house price changes (D)	+ ↑ level of transparency for investor products secured by mortgaged property (I)	+ ↑ costs for compiling data (D)	n.a.
Non-credit institutions and servicers					
Further analysis (Option 1)	n.a.	n.a.	n.a.	n.a.	n.a.

7.3. Implementation of preferred policy options

In terms of implementing the preferred policy options, two scenarios can be envisaged.

First, the individual measures could be implemented in a 'big bang' scenario, i.e. all measures would be implemented at the same time. On the one hand, this would enable a consistent policy approach to mortgage credit and maximise synergies between the different actions. On the other hand, implementing all policy options at the same time runs the risk of premature action that is not thoroughly thought through or of delaying policy options which could be implemented relatively fast, thereby withholding unnecessarily the delivery of their benefits.

Second, the individual measures could be divided into subgroups of measures. Sub-packages could be designed to take into account the nature of the measures, the urgency and the degree of understanding of the issue. For example, all legislative actions could be grouped together in one legislative act. This approach would avoid the shortcomings of the 'big bang' scenario such as that policy options are unnecessarily delayed or that the required analytical work on certain issues, for example on residential mortgage backed securities, would be cut short or its results anticipated. Furthermore, a clear indication on what measures are envisaged in the different areas and when they are to be implemented would help Member States and market players to plan ahead. The publication of the Commission's plans would also provide a degree of legal certainty for the next few years.

In conclusion, the division of individual measures into subgroups of measures seems to be the most appropriate approach in terms of implementing the preferred policy options.

8. MONITORING AND EVALUATION

A comprehensive monitoring and evaluation programme can only be developed once detailed proposals have been made. The Commission will continue monitoring the development of European mortgage loan markets in order to proceed with this initiative, taking into account: competition and efficiency (e.g. residential mortgage market concentration, price convergence); product diversity (e.g. product completeness index); consumer confidence (e.g. Eurobarometer, consumer testing); mortgage lender confidence (e.g. direct and indirect cross-border activity).

9. CHANGES MADE IN RESPONSE TO THE IMPACT ASSESSMENT BOARD OPINION

On 17 October 2007, the Impact Assessment for the White Paper on the integration of EU mortgage markets was presented to the Impact Assessment Board. The Impact Assessment Board adopted its Opinion on 22 October 2007[102]. The Board concluded that the Impact Assessment presented a rigorous and comprehensive problem analysis, clearly identifying the underlying problem drivers and the impacts of possible policy measures on different stakeholders. The Board focused on six recommendations to potentially improve the Impact Assessment. These have been incorporated into this revised version of the Impact Assessment.

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102 The Opinion of the Impact Assessment Board will be published alongside this impact assessment.

The Board recommended strengthening the analysis on the overall consumer welfare implications of an integrated EU mortgage credit market in the report. The Impact Assessment Report includes a more detailed analysis of the impact of the package on different stakeholders. In particular, the benefits for consumers have been more comprehensively explained and additional statistical evidence included. Particular attention has been given to explaining both the positive and negative impacts of the package on groups of vulnerable consumers, such as sub-prime borrowers. In addition, the views of the main different stakeholders groups (consumers, mortgage lenders, and Member States) on each topic have been incorporated into Annex 3.

The Board suggested reinforcing the market analysis in the report. The economic market analysis contained in Annex 1 has been further developed to better explain the overall structure of EU mortgage markets. A concise summary of the market analysis and data contained in Annex 1 has been incorporated into the Impact Assessment Report.

The Board requested that the cited macro-economic studies on the potential economic benefits were better presented and qualified. A box has been introduced to the Impact Assessment Report explaining how the results of the different studies assessing the potential economic costs and benefits should be interpreted. The box describes different methodologies; different statistical data (adjusted prices vs. non-adjusted prices); different assumptions; were published on different dates (2003 vs. 2005); and different time horizons (benefits per annum vs. accumulated benefits over a ten year period). The analysis confirms the fact that although the two studies do not provide identical results, they are broadly comparable in terms of their outcome and both illustrate a strong benefit from integration.

The Board emphasised that the report should identify more precisely the possible synergies and trade-offs between options. The section describing the package has been elaborated and the synergies between different options described. The measure in which a clear trade-off has been identified has been highlighted.

The Board asked for clarification of the need for adequate 'financial education' instruments. In response to the Board's comments, the section on financial education in Annex 3 has been elaborated. The revised section outlines possible policy options and assesses their potential impact, concluding that the Communication on Financial Education is the appropriate policy response. This revised Impact Assessment Report also considers the risks of increased product diversity reducing market transparency and comparability.

The Board requested that the analysis of the impact on administrative burden be strengthened. Drawing on the analysis in Annex 3, the impact on Member States in terms of administrative burden has been elaborated and strengthened.