



EMF – Eurofinas Position on Pre-contractual Information, Advice, Suitability Assessment, Product Standardisation and Foreclosure

1. INTRODUCTION

The European Mortgage Federation¹ (EMF) and Eurofinas², as specialised Product Federations respectively representing mortgage and consumer credit providers, have a shared interest in a number of issues central to consumer confidence, particularly pre-contractual information. Together, our two Federations attribute primary importance to the provision of adequate information i.e. information which is transparent and consistent, understandable, complete, focused on cost elements, and well balanced in order to avoid information overload.

Following the publication of i) DG Markt's final report on *the consumer testing of possible new format and content for the ESIS on home loans* and ii) DG Health and Consumers' staff working document on *the follow-up in retail financial services to the consumer markets scoreboard*, both Federations, the EMF and Eurofinas, have contributed to and endorsed each other's position on the issues detailed below.

¹ The European Mortgage Federation (EMF), which represents over 75% of the EU mortgage Industry, is the voice of the mortgage industry in the EU on both the retail and the funding sides of the business. The mortgage industry is a major driver of the general EU economy. At the end of 2008, outstanding mortgage loans amounted to €6.1 trillion, which is equal to 49.8% of aggregate EU GDP.

² Eurofinas, the European Federation of Finance House Associations, is THE voice of specialised consumer credit providers in Europe. It currently represents 17 Member Associations, in turn bringing together more than 1,000 finance houses, captive companies, specialised and universal banks. Together, these consumer credit providers financed over 400 billion euros worth of new loans during 2008 with outstandings reaching 745 billion euros at the end of the year.

2. EXECUTIVE SUMMARY

Pre-contractual Information

- We are pleased to note that individual **consumers have reacted positively** to the concept of the ESIS itself and to the modifications proposed to the ESIS variants.
- We **welcome the consultant's proposed modifications** to the format, language and content as being consistent and useful.
- We trust that the outcome of the ESIS Testing will **respond to concerns relating to format and language** in pre-contractual information raised by DG Health and Consumer Protection in its September 2009 Staff Working Document.
- We are concerned about the **practical interaction between the ESIS and the SECCI** in those Member States where the scope of the new Consumer Credit Directive (CCD) has been enlarged to include mortgage credit.
- We would welcome guidance from the European Commission on this issue.

Advice

- Financial advice is a **separate tailor-made product** to be **requested and paid for separately** by consumers, and it should be recalled in this context that not every prospective borrower needs advice.
- Any **responsible lending practice does per se include explanations** to the consumer in face-to-face situations, as is already the case by way of the implementation of the ESIS, and will be formally required for consumer credit products once the CCD will have been transposed into local regulatory frameworks.

Suitability Assessment

- Suitability assessments are of **no added value** for mortgage and consumer credit products **where a thorough creditworthiness assessment** is performed.
- Suitability assessments contain subjective elements which could be perceived as a **limitation on the borrower's party autonomy and contractual freedom**.
- The lender is not in a position to assess a borrower's personal circumstances (which may also change throughout the term of the loan). Any potential liability of financial institutions stemming from the product choice should in any case be avoided. It is the **consumer who must make an informed choice** after due consideration of their personal circumstances.
- What is needed at EU level is **adequate pre-contractual information and product transparency**, accompanied by **improved financial literacy**.

Product Standardisation

- We regard any kind of product certification/standardisation as being **contrary to a free market economy** and a **barrier to product innovation** and fluidity in product development which is essential to a dynamic credit market.
- Standardisation would create **unnecessary competitive distortions** and **decrease the availability of products**.

Foreclosure

General

- **Sustainable access by consumers to credit is a priority for lenders.** One of the overriding requirements of viable lending is that lenders provide finance to borrowers who can repay the credit with the agreed interest. The opposite would not make any economic sense.
- Accordingly, lenders grant loans **on the basis of an assessment of the borrower's ability to repay** based on their income and, in the case of mortgage credit, the security, and not only on the lender's ability to foreclose/repossess.
- Lenders are **committed to helping customers in financial difficulties**. All such cases are treated sympathetically and positively with a view to finding solutions to the problem at an early stage in the interest of both parties. Lenders often work closely with **debt advice organisations** to help borrowers seeking advice about their debts.

Mortgage Loans

- It is the **lender's aim to prevent as far as possible the realisation of the security**. Where this is consistent with regulatory guidance and realistic, attempts to reach alternative arrangements with the borrower will be given preference to enforcement measures.
- However, this does not in any way change the fact that the **possibility to foreclose**, even if not exercised in the end, **is a key feature of the mortgage lending business**.
- **Restrictions** on mortgage lenders' ability to foreclose would have a **dramatic impact**, particularly with regard to capital and funding.
- Significantly, arrears and foreclosures rates are **exceptionally low** in absolute terms and lower than witnessed during the last housing recession.

Consumer Credit

- Repossession is equally important to all **other providers of secured lending**.
- Repossession is costly for both lenders and consumers and **preference will therefore always be given to alternative solutions**. Possession is only taken as a last resort, when all other reasonable options have been explored or considered.

3. PRE-CONTRACTUAL INFORMATION

- *Mortgage Credit: DG MARKT Report on the Testing of the ESIS*

Before going into more detail on the conclusions of the Final Report on the Consumer Testing of the ESIS, the EMF would like to take this opportunity to reiterate that, as the initiator of the 2001 Voluntary European Code of Conduct on Home Loans ("the Code"), it remains committed to the Code, which it strongly believes is the adequate tool to enable consumers to make informed decisions about Home Loans based on transparent comparison.

Against this background, the EMF has closely followed the consumer testing of the European Standardised Information Sheet (ESIS) by OPTEM and welcomes the publication of the *Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans* ("Final Report on the Consumer Testing of the ESIS").

We are pleased to note that the testing with individual consumers has proved to be positive regarding the concept of the ESIS itself and on the modifications proposed by the ESIS variants. These were developed by the Consultant on the basis of the outcome of the first phase of the testing, and have been met with very favourable reactions from consumers. Already back in May 2009, on the occasion of a DG Internal Market and Services Hearing to discuss the results of the first phase of the consumer testing, the Industry agreed with the results presented by the Consultant, and appreciated the quality and the sensibility of the work undertaken during the first phase of the testing. The changes proposed by the Consultant for the format and language as well as for the content appeared to be consistent and useful:

- *Format and Language*

The EMF is pleased to note that a key element which finds unanimous support amongst consumers is the ESIS format proposed by the Consultant, because it encourages comparison between various offers "by profiting from the standardised character of the sheet to compare much more easily the features of the loan offered"³. Indeed, as the Commission is aware, **we have always supported the principle of standardised pre-contractual information**, in the form of the ESIS, as the most efficient way to ensure transparent and comparable information both in the borrower's Member State and on a cross-border basis.

The EMF does however take note of the testing results indicating that consumers have difficulties in understanding certain aspects of information elements included in the current ESIS, e.g. the nominal rate and APRC, recurrent and non-recurrent additional costs, the amortisation table, and therefore welcomes and supports the Consultant's proposals to further clarify and improve these as appropriate, by way of improved presentation and simple explanations in the ESIS variants.

³ Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, October 2009, p. 14.

In this respect, the EMF understands from the Final Report on the Consumer Testing of the ESIS that the Consultant notes “the frequent existence of a lack of knowledge, uncertainties and erroneous interpretations”⁴ on the part of consumers when presented with the titles of the information elements, without the content. The EMF would like to point out that the Study does not explore the question of whether or not these perceived shortcomings of the ESIS stem from a lack of consumer education/capability rather than from problems with the language of the Code itself. Interestingly, according to the *2008 OPTEM Report on Pre-Contractual Information for Financial Services* commissioned by DG Health and Consumer Protection in 2007 (“2008 OPTEM Report”), a vast majority of consumers found the language used in the current ESIS to be “clear and simple”⁵ and “less complicated than they feared”⁶.

However, this does not mean that there is no room for improvement and in fact, we join with the consumers interviewed in their support for the consultant's modifications to the language used as being of added value to the ESIS, and as going a long way to addressing the risk of potential misunderstandings. The EMF would furthermore like to signal its support for the Consultant's proposed modifications, particularly in ESIS variant A, which aim for increased clarification and explanation, e.g. of the APRC and the illustrative repayment table. This support would appear to be shared by consumers who themselves indicated that the additional explanations provided in ESIS version A be taken up in a combined variant including elements of ESIS version B, indicating that these explanations are considered to be of added value⁷.

We find the proposal to join together similar information elements, such as the nominal rate and the APRC, to be a very sensible one with a view to further increasing transparency and comparability. Again, this assessment would appear to be shared by consumers, who express a preference for ESIS version B, which groups together a number of the main features of the loan⁸.

Finally, and as expressed during the discussions of the 2006 Mortgage Industry & Consumer Dialogue Group (MICDG), the Industry is strongly committed to adequate information, which necessarily always includes explanation in face-to-face situations. However, a lack of knowledge or the risk of misinterpretation will not be addressed by clearer language and simpler explanations alone. From our point of view, consumer information and financial literacy must go hand-in-hand. As such, we strongly welcome and support the European Commission's on-going initiatives to increasing financial literacy, which is fundamental if consumers are to derive the maximum benefits from the single market in financial services.

⁴ Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, October 2009, p. 17.

⁵ OPTEM Report on Pre-Contractual Information for Financial Services, January 2008, p. 77.

⁶ OPTEM Report on Pre-Contractual Information for Financial Services, January 2008, p. 77.

⁷ Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, October 2009, p. 12.

⁸ Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, October 2009, p. 12.

- *Content*

We welcome the addition of risk warnings to the ESIS. In fact, this addition, together with that of information on foreign currency loans - dealt with in more detail below - coincides with two proposals put forward by Consumer Organisations during the discussions of the MICDG, which the Industry agreed could bring real consumer benefit. The apparent importance of risk warnings for consumers is evidenced in the Report by the fact that all or virtually all consumers favour the inclusion of clear warnings concentrating on the major risks⁹.

Moreover and as indicated above, we strongly believe that the proposal by Consumer Organisations made during the MICDG discussions to include specific information in the ESIS in the case of a loan in a currency which is not the same as the currency of the consumer's salary (also referred to as "forex loans"), would also bring added value to consumers. The Consultant's proposals in this respect are therefore to be welcomed. Incidentally, we believe that in general terms, it is much more efficient to approach the subject of forex loans from the angle of pre-contractual information than from a capital requirements point of view, and would like to refer to an earlier EMF Position on the Capital Requirements Directive (CRD) setting out the reasons for this approach in more detail¹⁰.

The EMF would like to take this opportunity to respond to the assessment provided in the Report of consumers' attitudes towards foreign currency loans. We understand from the Report that on being presented with the relevant section of the ESIS variants, consumers expressed strong reservations to this type of loan. We would suggest that this perception of foreign currency loans is perhaps not necessarily surprising given that, as the Report itself underlines, "the vast majority have never thought of it – they are even sometimes surprised that they exist – and they spontaneously declare that they do not envisage them in any way whatsoever"¹¹. Indeed, in the vast majority of EU Member States, particularly in the former EU15, forex loans are not offered, and in the limited number of cases where they are, they are taken up by borrowers who use them knowingly for speculative purposes, fully aware of the implications and able to assume the potential consequences. Forex loans are however more generally available in the EU12 Member States, where sometimes high domestic interest rates mean that taking out a loan in a foreign currency can be the only way for a consumer to afford a mortgage loan.

In this respect, the EMF is confident that in the process of the revision of the ESIS, the Commission will take existing regulation and solutions by local supervisors in the EU12 into account which provide the borrower with additional information of FX and interest rate risk.

Interestingly, whilst some of the EU12 Member States have signalled certain problems associated with forex loans, the Polish Mortgage Foundation has indicated that according to statistics of the Polish Financial Services Authority, within the banking portfolio there is evidence that the default

⁹ Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, October 2009, p. 21.

¹⁰ EMF Position on CRD-4 of September 2009: <http://www.hypo.org/Content/default.asp?PageID=444> .

¹¹ Final Report on the Consumer Testing of Possible New Format and Content for the ESIS on Home Loans, October 2009, p. 95.

rate of forex loans has been two times lower than own currency loans (since their rise in popularity from 2005). What is very important is that in both cases, i.e. foreign as well as own currency loans, the respective characteristics are clearly presented and explained to the prospective borrower.

More than the currency itself, the key criteria in the case of forex loans is the coincidence/divergence between the currency of the borrower's salary and that in which the loan is granted. Clearly, it is all the more vital for a borrower to be fully informed and fully aware of the potential implications of currency fluctuations in those cases where the loan is in a currency which is not the currency of his/her salary.

To conclude on this section, it is promising for the future use and effectiveness of the Code that the consumers with whom the variants were tested and the Industry appear to agree on and welcome to a large extent the proposed modifications to the ESIS. However, this positive evaluation by consumers at grass roots level has not necessarily been shared with consumer associations as such in the past, judging from feedback received during the May 2009 Hearing on the subject.

▪ ***Mortgage & Consumer Credit: DG Health and Consumers' Staff Working Document***

Consumer information has been on the EU agenda for some time and in September 2009, DG Health and Consumers (DG SANCO), for its part, published a *Staff Working Document on the Follow-Up in Retail Financial Services to the Consumer Markets Scoreboard* ("Staff Working Document"), with a focus on four key issues, one of which is pre-contractual information. In the light of i) the publication of the Final Report on the Consumer Testing of the ESIS and ii) the recent adoption of the Consumer Credit Directive, we would like to respond to a number of points raised by DG SANCO in its Staff Working Document.

▪ *Format and language*

Firstly, we acknowledge the findings of DG SANCO's Special Eurobarometer 298 that "incomprehensible, insufficient and misleading information and information which is presented in too many different ways when comparing different offers"¹² is an important barrier to cross-border comparability. With this in mind, we are very pleased to note, as DG SANCO points out, that OPTEM's 2008 Report on Pre-Contractual Information for Financial Services shows consumers to strongly approve of the ESIS' standardised format.

In the general remarks on pre-contractual information in its Staff Working Document, DG SANCO also indicates that in the course of the focus groups on pre-contractual information requirements in financial services preceding the 2008 OPTEM Report, *"consumers strongly criticised the complex language using difficult financial or legal jargon. The group members evinced considerable distrust towards financial services providers, based inter alia on opaque language which makes them*

¹² Special Eurobarometer 298, June 2008, QC23, p. 127.

*believe that banks intend to hide unfavourable conditions*¹³. Positively and as recalled earlier in this Paper, this same Study also indicated that in the specific case of pre-contractual information on Home Loans, consumers deemed the language used in the ESIS to be “clear and simple”¹⁴.

Despite the largely positive reception of the current ESIS by consumers interviewed for the 2008 OPTeM Report, we nevertheless acknowledge the view of consumers as expressed in this Report, and in the Final Report on the Consumer Testing of the ESIS, that certain elements of the current ESIS could still be improved, and are confident that the subsequent modifications proposed in the Final Report on the Consumer Testing of the ESIS, for example regarding language and additional explanation, will respond to any remaining concerns. As indicated above, we strongly welcome improvements and clarifications to the current ESIS, which will bring consumer benefit.

For consumer credit, according to article 5 of the CCD, lenders and credit intermediaries, where applicable, should provide consumers with the information needed to compare different offers in order for them to take informed decisions on whether to conclude a credit agreement or not. As mentioned in the Staff Working Document, this information will be provided by means of the Standard European Consumer Credit Information (SECCI) form.

We believe that adequate information is an essential element for the sustainable provision of credit. In this context, we support the provision of adequate pre-contractual information to applicant borrowers to facilitate comparability of offers and assess whether they wish to enter into a contractual relationship with the lender.

We are therefore very supportive of the principle of providing pre-contractual information in a standardised format. However it is worth recalling that the overall information provided to consumers by means of the SECCI will be far from succinct. Indeed, all the information included in the SECCI is actually provided in the draft credit agreement. In some cases it is therefore questionable whether the SECCI will reach its objective while avoiding information overload.

- *Timing*

DG SANCO’s Staff Working Document also considers the question of the timing of pre-contractual information. As the European Commission will be aware, the specificities of consumer credit lending transactions as regards handing over of pre-contractual information are reflected in the new European regulatory framework for consumer credit agreements.

As regards Home Loans, the question of the timing for the handing over of the Code’s ESIS is a recurrent issue, and has also been a stumbling block in discussions with consumer representatives, who insist that the ESIS be handed over as early as possible to consumers and at a point in time which is harmonised across the EU, to allow for shopping around. Indeed, the lack of a precise

¹³ DG Health and Consumer Protection Staff Working Document on the Follow-Up in Retail Financial Services to the Consumer Markets Scoreboard, September 2009, p. 6.

¹⁴ OPTeM Report on Pre-Contractual Information for Financial Services, January 2008, p. 77.

moment for handing over the ESIS to consumers has been identified by DG SANCO and European consumer organisations as one of the major shortcomings of the Code.

The Commission may recall that the European Banking Industry Committee (EBIC), against this background and further to an extensive survey of its membership, wrote to the then Commissioner Byrne in October 2004¹⁵ signaling that despite their diversity, the loan-granting processes in the different Member States do allow the ESIS to be handed over to the consumer in time for shopping around, including in cases where the ESIS is given together with the offer.

Consumers themselves have expressed their satisfaction with the date of receipt of pre-contractual information, as observed on page 72 of the 2008 OPTEM Report. Moreover, consumers interviewed for the Study confirmed that the practice of pre-contractual information provision during the face-to-face interview with the bank when a personalised loan plan is drawn up poses no concern for them. This implies that there is no need to pinpoint a precise harmonised moment for pre-contractual information to be handed over to the consumer, provided it is at the latest together with the offer as agreed during the negotiations with Consumer Organisations on the Code, which still gives the prospective borrower adequate time to shop around and make a decision. In actual fact, in a number of Member States, e.g. AT, BE, CY, DE, EE, GR, IT, LUX, PT, SF and the UK, the ESIS is handed out at an even earlier stage in all or almost all cases, before the lender provides a binding offer, therefore apparently surpassing consumers' expectations in this respect.

We therefore trust that on the basis of these elements, DG Health and Consumers' concerns regarding the timing for handing out pre-contractual information relating to Home Loans and Consumer Credit are allayed.

▪ ***Home Loans ESIS v. Consumer Credit SECCI***

The potential extension of the scope of the CCD to mortgage credit raises an important question with regard to pre-contractual information, namely the potential implications for the ESIS if the CCD's provisions on pre-contractual information, including the SECCI, are applied to mortgage credit.

A primary concern would be that the **SECCI is designed specifically for consumer credit products**, and therefore fails to fully reflect the specificities of Home Loans. Therefore, informing consumers through the SECCI rather than the ESIS would render information on Home Loans less pertinent. Furthermore, **the objective of cross-border comparison on would become redundant** if Member States who intended to apply the CCD to mortgage credit decided also to apply the SECCI in preference to the ESIS.

The EMF and Eurofinas are encouraged to note that in certain Member States, where at least parts of the CCD will be applied to mortgage credit, for example in Denmark and Germany, the **national**

¹⁵ See EBIC Letter to Commissioner Byrne, dated 19 October 2004 at www.hypo.org.

regulator has decided to allow lenders to nevertheless provide the ESIS to the prospective borrower and thereby dispense with their information obligations under the CCD. The EMF and Eurofinas consider this to be a pragmatic solution to the ESIS/SECCI dilemma and would welcome feedback from the European Commission on this issue.

4. ADVICE

The EMF and Eurofinas very much agree with the evaluation of the Commission in its Mortgage Credit White Paper of 18 December 2007 that advice is a separate service, distinct from the provision of information. To recall, financial advice is a separate product, to be requested and paid for separately by consumers. It should also be borne in mind that not every prospective borrower needs advice. The EMF and Eurofinas therefore share and strongly support the Commission's view as expressed in its White Paper that advice must not be provided by the lender on a compulsory basis. In any event, any responsible lending practice does *per se* always include **explanations** regarding the product to the consumer in face to face situations, as is already the case by way of the implementation of the ESIS, and will be formally required for consumer credit products once the CCD will have been transposed into local regulatory frameworks.

▪ **Suitability Assessment**

In its Staff Working Document, DG SANCO highlights the problem of the reliability of advice and the conflict of interest inbuilt in remuneration systems. It is worth noting that the evidence on unsuitable advice related in this paper stems notably from the investment product sector. The EMF and Eurofinas cannot insist enough upon the **inherent difference between credit products** on the one hand **and investment products** on the other, consisting notably in the fact that with investment products, the client disposes of own funds, whereas in the case of granting a credit, it is the lender's funds that are being allocated to the borrower.

This considerable difference should be adequately reflected in any policy approach to the respective product, and whereas suitability tests may have been considered the right way forward for investment products, this is not the case for credit. In our view, **suitability assessments are of no added value for mortgage and consumer credit products where a thorough creditworthiness assessment is performed**. The introduction of a compulsory suitability assessment similar to the one performed by investment firms when providing investment services to their clients (as required by the Markets in Financial Instruments Directive) would constitute a disproportionate burden, without producing any valuable results.

The single most important aspect in this regard is that the lender and the lender's staff have an inherent interest in granting responsible, long-term credit, both for their own benefit and the consumer's¹⁶.

¹⁶ See *EMF Responsible Lending Standards*, http://www.hypo.org/Objects/6/files/FINAL_EMF_Responsible_Lending_Standards-26October2009.pdf.

Indeed, the appropriateness of denying a prospective borrower access to credit/housing finance, despite the fact that his/her repayment capacity has been established by a creditworthiness assessment, is questionable. Moreover, lenders' decisions should be based upon commercial judgment. In contrast, "suitability" assessments contain subjective elements that could be perceived as a **limitation on the party autonomy and contractual freedom on the part of the prospective borrower, or even in some cases bordering on discrimination and an invasion of privacy**. To recall, it is generally agreed by both the Industry and consumer organisations¹⁷ that the final decision on whether or not to take out a loan should remain with the prospective borrower. This is also the outcome of the CCD. In this respect, it is important that borrowers should take up their responsibilities and shop around to compare offers. Moreover, account should also be taken of the fact that there often is a consumer preference to arrange finance at point-of-sale.

The added value of a suitability test, in addition to creditworthiness assessments, is doubtful. It should not be forgotten that any suitability assessment would be broadly based on information provided to the lender by the borrower himself. Hence, **a significant amount of the information** considered of relevance to a suitability assessment **can be difficult to verify**, and the lender is therefore not in a position to decide whether a product is suitable for the consumer. This is in line with the recently adopted CCD which emphasizes that the consumer himself should assess the suitability of a credit, after being informed properly by the lender.

On the other hand, creditworthiness can to a certain extent be verified notably by way of access to credit databases, although the accuracy, level of detail and coverage of credit histories varies between databases/Member States.

Besides, borrowers' circumstances are subject to change, and lenders can only make assessments at a particular point in time. As already pointed out, the majority of debt situations occur when borrowers experience payment problems due to unpredictable changes in circumstances after the loan was taken out such as unemployment, relationship breakdown or illness. Whenever the consumer's personal situation changes, a product which may previously have been deemed suitable may suddenly appear inappropriate. Once the borrowing decision has been made, any potential liability of financial institutions stemming from the product choice should in any case be avoided. The assessment of the advantages and disadvantages of credit product needs to be left to consumers' discretion. In the end, it should be the consumers who make an informed choice after due consideration of their personal circumstances.

The Commission has not, to date, provided evidence of a significant problem whereby borrowers are being granted unsuitable mortgage or consumer credit products. A cost/benefit analysis would be the precondition for any case for action in this regard.

¹⁷ Agreement was found during the negotiations on the 2001 Voluntary European Code of Conduct for Home Loans, and this solution was later recorded in the Code itself.

But most importantly, and as alluded to above, the "suitability" concept itself is not relevant as far as credit products are concerned. Suitability assessment is provided for in the MIFID only in relation to investment advice and portfolio management. Suitability assessment is not appropriate for the distribution of credit, since credit providers are not advisers, except when they provide a separate and personalised service separately requested and paid for by the prospective borrower.

Moreover, given the evidence put forward by the Staff Working Document on remaining difficulties notably in the investment products sector, one could consider reassessing the very efficiency of imposing a suitability requirement by way of regulation (MiFID Directive 2004/39/EC).

In parallel, we would like to draw the Commission's attention to the potential risks of product suitability assessments. This could include driving the market to monoline products and making the credit granting process less flexible. A suitability assessment implies subjective elements which are part of an advice mechanism and which, in our opinion, are not appropriate for the provision of credit products.

Instead, what is needed at European level, and what we promote to the benefit of borrowers, is **adequate pre-contractual information and product transparency, as core elements of an efficient consumer confidence policy within an integrated mortgage and consumer lending market**. In this context, too, we would like to highlight that the benefits to be derived from improving financial literacy, as a both relevant and proportionate tool, appear to be currently underestimated¹⁸.

- ***Ensuring high quality advice standards***

Advice depends on borrowers' needs and personal circumstances which are different from one borrower to another. Advice has to be tailor-made, and is therefore best designed as a flexible tool at Member State level. The European level is not best suited to the definition of high-quality advice standards. In any event, any measures in this area should always be seen against the background of initiatives on financial literacy, and also include work on the competence/professional qualifications of advisers.

It should not be forgotten that the specific characteristics of advice as a tailor made service mean that it is up to the adviser to provide an adequate service, complementary to information and explanation. If the advisor cannot fulfill this task, he will be naturally excluded from the market.

Finally, any criteria for high-quality advice should not be designed to stifle product diversity by automatically advising consumers not to opt for products of higher potential benefits which may be somewhat less calculable.

¹⁸ See Eurofinas E-publication on Financial Education, October 2009 at www.eurofinas.org

5. PRODUCT STANDARDISATION

In its Staff Working document DG Sanco highlights that “one approach which could be assessed with the application of behavioural economics tools could be the introduction of optional, simplified standardised or certified products”. The EMF and Eurofinas regard any kind of product certification/standardisation as being contrary to a free market economy and a barrier to product innovation and fluidity in product development which is essential to a dynamic credit market.

Based on culture and traditions, consumers needs and wants vary from one MS to another. Whether a given product meets the respective borrower's needs therefore depends on the specific circumstances that prevail when entering into an agreement. The debates which took place during the drafting of the Consumer Credit Directive on the definition of “consumer credit” show how the promotion of common standardised elements is extremely difficult if not impossible.

In parallel, we would like to emphasise that lenders do not grant loans as a one-off business proposition, but are looking forward to a long-term relationship with their customers. The long-term quality of lenders' portfolio is vital. Before launching a credit product lenders therefore conduct numerous assessments. Standardisation would create unnecessary competitive distortions and decrease the availability of products. Product standardisation can also result in increased costs for the lender, because not every lender can adapt its system to a (mandatory) standardised product.

The EMF and Eurofinas believe that promoting good practice in itself is laudable. However, regulating products through standards would bring no added value. Instead, having robust principles of transparency, information and competence (i.e. having a clear governance framework) would be more beneficial in terms of consumer protection.

6. FORECLOSURE

Considering the way forward for mortgage policy, the EMF believes a very important conclusion was reached at DG MARKT's Hearing on 3 September 2009 by representatives of the European Parliament. The Chairs both of its Internal Market and Consumer Protection Committee, and its Economic and Monetary Affairs Committee highlighted the **significant differences prevailing across Member States' markets in the mortgage sector** and the complexity of existing national rules e.g. on the transfer of real estate ownership. This meant that already before the crisis, attempting to further increase the level of integration with regard to already largely integrated EU mortgage markets was of no added value, and post-crisis, the policy focus has rightly shifted on restoring liquidity and confidence¹⁹.

Acknowledging the vast differences remaining at national level in this field, notably with regard to national procedural law relevant to the execution proceedings, the EMF considers that in order to

¹⁹ The EMF has contributed to these objectives by way of its recently adopted *EU Responsible Lending Standards*, published on <http://www.hypo.org> on 2 September 2009.

take account of the different loan origination processes existing across the EU, a well-targeted approach is needed, which is best delivered by tailored measures at national level²⁰.

Although being aware that DG MARKT's initiative on foreclosure prevention is intended to be a benchmarking exercise at this stage, the EMF would nevertheless like to emphasise the potentially **dramatic impact** that **any restrictions placed on lenders regarding foreclosures** would have, especially with regard to capital and funding, and all the more so in a context where lenders need to recover from the current crisis.

Mortgage lenders in the EU very much embrace the provision of **sustainable long-term access to housing for borrowers**. Responsible lending, as actively practised by EU mortgage lenders, aims not only at providing the initial access to housing through mortgage credit for borrowers, but also at the long-term objective of keeping borrowers in their homes, for instance as financial security for old age.

Accordingly, it is EU-wide practice to grant loans based on the **strict assessment** of prospective borrowers' **capacity to repay their loan based on their income and the security**, and, in the case of mortgage credit, based on the possibility to enforce the collateral. If "credit means trust", as suggested on the occasion of the Commission Hearing on Responsible Lending and Borrowing in September 2009, then this trust has to be established on both sides: prospective borrowers need to be confident that the information they are given is adequate, and lenders need to be confident that borrowers are, in principle, able to repay their loan.

It should also be recalled that it is the lender's aim to prevent as far as possible the realisation of the security. Where this is consistent with regulatory guidance and realistic, attempts to reach alternative arrangements with the borrower will be given preference to enforcement measures. In this respect, it is noteworthy that the vast majority of cases where borrowers face difficulties in repaying their loans are solved amicably between lender and borrower. In some Member States, for example in Belgium, France and Italy, borrowers' financial difficulties are also resolved through collective debt settlement.

However, this stance does not in any way preclude the fact that for mortgage credit, the existence of the **collateral** and the lender's right to use it, i.e. to enforce the surety, constitutes a **key feature of the mortgage lending activity**, the restriction of which would put the industry at risk. On the contrary, the existence of this possibility has a decisive influence on 1) the intrinsic value of the collateral itself, 2) the level of capital requirements, 3) the length of the loan's life, 4) the ratings for bonds, and 5) most importantly, on the lower interest rates that lenders can offer to prospective borrowers, and 6) indirectly, common and general access to loans. Moreover, it is worth recalling that lenders' rights to resort to the enforcement of the collateral is not just left to their "good will"; it is very strictly framed by Member States' national legislative frameworks.

²⁰ See EMF letter to Jorgen Holmquist of 24 July 2009.

EU credit institutions are required to comply with the **Capital Requirements Directive (CRD)**, which determines the minimum amount of capital that a bank must set aside for each lending transaction, thus protecting the bank against the risk of borrower default. In this context, mortgage (i.e. secured) loans are afforded a preferential risk rating, which, in turn, allows for a favourable capital treatment. However, to achieve this **preferential risk rating**, it is a **condition that the collateral can be used/enforced** when deemed necessary by the lender (within the national legislative framework).

This is why encouraging any kind of measures that would restrict banks' ability to enforce the collateral would run directly against these legal requirements. The imposing of a compulsory moratorium, for instance, would result in the loans being considered of greater risk as the underlying security would be rendered ineffective for a given period of time. Consequently, banks would be faced with the obligation to **set aside a larger amount of capital** to cover this risk, which would lead them to **increase the rates charged for such loans** and even **reduce their ability to grant such loans**.

Furthermore, many **securitisation agreements** include contractual obligations that aim at **penalising the lending institution that fails to pursue arrears**. Taking again the example of a moratorium, the greater the length of the moratorium, the more severe the impacts may be. Also, rating agencies have made it known that impediments to enforcing the security could be viewed in an even more serious light, making the ratings more severe for institutions.

In summary, the creation of uncertainty with regard to the enforcement of the collateral would lead to a situation whereby **mortgage loan backed securities' ratings would be significantly downgraded**, with the direct consequences of increased capital requirements and cost of funding. In either scenario these higher costs incurred by the lender will be reflected in the interest rates offered to borrowers and/or lead to a reduced availability of mortgage credit in an increasingly risk adverse market.

Significantly, from a **borrower point of view also, prolonging and/or postponing foreclosure proceedings ultimately increases the final cost**. In this respect, the adoption of the **Commission's Draft Recommendation** remains a must, because the efficiency of the foreclosure procedure, once it has been launched, is in the interest of the borrower as well as of the lender (it being understood that improved efficiency is in the interest of both parties and does not in any way imply making it easier for lenders to enforce the collateral).

- ***DG Health and Consumers' Staff Working Document***

Finally, the EMF and Eurofinas would like to comment on DG SANCO's *Staff Working Document on the Follow-Up in Retail Financial Services to the Consumer Markets Scoreboard* of 22 September 2009, which includes a brief paragraph on foreclosures, highlighting in particular foreclosure and default figures since the onset of the crisis.

However, when analysing recent trends in **foreclosure figures** in connection with the current crisis context, the broader picture of the economic cycle is often forgotten: in the wake of the **unusual economic boom** experienced by a number of countries, foreclosure figures have been significantly lower than under normal economic circumstances. Repayment defaults throughout 2009 have remained limited, and markets are picking up again as compared to the previous year. The growth in foreclosure rates in some countries appears large, but this is the expected effect of coming out of a period of unusually low arrears and foreclosures due to the housing boom. A recent EMF survey²¹ presents arrears and foreclosure data on a number of Member States, which demonstrate that although some markets are seeing an increase in arrears and **foreclosure rates, these remain exceptionally low in absolute terms and far lower than those witnessed during the last housing recession.**

The EMF therefore believes that against the backdrop of economic development and market conditions, the year 2008 cannot serve as a dependable baseline for a realistic picture of developments on foreclosure. The baseline to be chosen should ideally not coincide with either a peak or a trough in the economic cycle, which would suggest, rather, using the year **1985 or 1990 as a baseline.**

²¹ Updated EMF Position on Foreclosure Prevention of 21 January 2010.