



Brussels, 22 March 2006

Final Draft EMF Position Paper on the Commission's Proposal for a Directive on Credit to Consumers dated 7 October 2005

The European Mortgage Federation (EMF)¹ welcomes the publication of the new modified Proposal for a Directive on Credit to Consumers released by the European Commission on 10 October 2005 (CCD-Proposal) as a marked improvement on the previous one.

As such, the EMF is pleased to note that the Commission has taken on board its calls for the exclusion of all mortgage credit, specifically mortgage equity withdrawal loans², from the scope of the Directive. The Federation has always maintained that mortgage equity withdrawal loans, being mortgage loans, do not fit into a legal framework specifically designed to address consumer credit products. Mortgage loans are different, long-term products, often funded through long-term instruments, such as mortgage bonds and mortgage-backed securities, with a low risk profile and low interest rates. What is more, it would make no sense to split mortgage credit between two different regimes, i.e. the Directive and the Code of Conduct on Home Loans (Code of Conduct).

Furthermore, as already stressed in the Federation's Position Paper dated 8 January 2003, the EMF approves of the improvement and harmonisation of information for consumers. Appropriate information is the only means to enable the consumer to make the appropriate choice according to his personal circumstances. Against this background, the EMF has supported the principle of full harmonisation of information through the adoption of the Code of Conduct which was negotiated with Consumer Associations. In this vein, the EMF welcomes the adoption of a new basis for the calculation of the annual percentage rate of charge (APRC) that would lead to the same components being included in all of the Member States providing consumers with a piece of information which is truly comparable. Harmonisation of information is all the more important in the context of the Single Market where consumers have access to a much wider range of products to choose from.

However, there are a number of issues which still raise some concern amongst mortgage lenders. These issues involve in particular the scope of the Directive, the definition of "credit intermediary", the concept of "total cost of the credit" being used as the basis to calculate the APRC, the "principle of responsible lending" and the "duty to explain and to assist" and the new approach adopted by the Commission with respect to the "implementing measures".

¹ The European Mortgage Federation is the voice of the mortgage industry at EU level. It groups together both national associations and individual lenders from EU Member States and Accession Countries. Together, the Federation's members grant over 75% of residential and commercial mortgage loans in Europe. Mortgage lending is a growth industry, total loans outstanding at end 2004 amounted to € 4.7 trillion.

² They are referred to as "equity release loans" too.



1. Scope

The EMF welcomes the exclusion of all credits “secured either by a mortgage on immovable property or by another comparable surety commonly used in a Member State” (therefore excluding mortgage equity withdrawal loans from the scope of the Proposal) on the grounds that mortgage loans are very different, long-term products, often funded through long-term instruments.

However, the Federation is very much concerned that the emphasis given to the existence of the mortgage/real estate collateral with respect to the exclusion of mortgage equity withdrawal loans has led the Commission to modify the drafting of the definition of Home Loans as it exists in the Code of Conduct and therefore to leave aside the criterion of the purpose of the loan. As a consequence, loans secured by sureties commonly used in a Member State, such as for instance personal guarantees, which are non real estate-secured loans (currently covered by the Code of Conduct) are no longer excluded from the scope of the Directive (see Recital 13, page 12 of the modified CCD-Proposal). In this respect, the Federation strongly believes that these loans must be excluded, because they are similar to mortgage credit in that they are long-term products with their own specificities.

Indeed, due to the characteristics of these non real estate-secured loans, the negotiators of the Code of Conduct considered them to be similar to real estate-secured loans which is the reason why they included them in the Code alongside the latter. What is more, these loans are included in the consultation on the Integration of European Mortgage Markets launched by the Commission. This is reflected in the wide definition of “residential mortgages” adopted by London Economics in its Report on the Costs and Benefits of Integration of EU Mortgage Markets covering both housing loans defined on the basis of the existence of a surety (real estate-secured and non real estate-secured loans) as well as loans defined on the basis of the purpose of housing³. Furthermore, if the current wording of article 2.2 (a) was maintained the Code of Conduct could be at risk, since two different legal regimes would apply to the same product, i.e. non real estate-secured loans.

Another important issue in relation to the scope of the modified CCD-Proposal is the treatment of unsecured housing loans, which exist in a number of countries. The Federation strongly believes that these loans should also be excluded from the scope, because they too are long-term housing products with the corresponding specificities.

In France, unsecured housing loans are loans granted under a “single financing package”, which encompasses one principle secured loan complemented by a number of smaller unsecured loans. The common feature shared by the principle secured loan and the smaller unsecured ones is that both are long-term housing products with their own specificities and granted to finance the same property. From the lender’s risk management perspective, these loans are granted in a context where the lender considers that the collateral pledged for the principle secured loan provides him with a sufficient guarantee.

In Germany, unsecured loans can be granted as individual loans and are as such independent from another secured loan. These loans are similar to mortgage loans not only

³ See London Economics’ definition of “residential mortgages” on page 12 seq. of the Study mentioned above which was published in August 2005 as part of the European Commission’s consultation process on Mortgage Credit.



because they are long-term products, but also because they are taken out for investment purposes. The value of the financed object is always equivalent in the real estate. Consequently, loans used for renovation purposes, for instance, which were excluded from the scope of the 1987 Consumer Credit Directive (see article 2 (1) lit. a)) for the above reasons, would now be included in the Directive according to the current wording of the modified CCD-Proposal.

Against this background, the Federation strongly believes that it would be inconsistent to apply two different legal regimes, i.e. the Code and the CCD. As a concrete example, in France, an obligation to apply these two regimes would result in the principle secured loan being subject to a 10 day reflection period before the signing of the contract, while the smaller unsecured loans would be subject to a 14 day right of withdrawal.

In light of the above, the Federation would recommend the endorsement of the version of article 2.2. (a) of the CCD-Proposal agreed upon by the European Parliament in its plenary meeting on 20 April 2004. Such an approach would also be in line with the findings of London Economics' Report. The revised article 2.2. (a) of the modified CCD-Proposal (page 19) would therefore read as follows:

"This Directive shall not apply to the following credit agreements:

- (a) credit agreements the aim of which is to grant credit for the purchase or transformation of the private immovable property that the consumer owns or aims to acquire or which are secured either by a mortgage on immovable property or by another surety commonly used in a Member State for this purpose."

Recital 13 (page 12) would need to be amended accordingly.

To conclude, the Federation welcomes the exclusion of mortgage credit as well as mortgage equity withdrawal loans (being mortgage loans for consumption purposes). It would however strongly insist on the further exclusion of non real estate-secured loans for housing as covered by the Code of Conduct, as well as unsecured housing loans based on the same arguments, i.e. that these are long-term products, often funded by specific funding techniques, and granted for housing purposes.

2. Credit Intermediary

In the Federation's opinion, the definition of "credit intermediary" requires further clarification. According to article 3 (e) of the CCD-Proposal (page 21) a credit intermediary means a natural or legal person, who acts on behalf of the creditor. In practice, loans are offered to consumers not only by persons acting "on behalf of the creditor" but also by a number of persons acting independently (generally referred to as brokers) and who may well not receive a fee from the lender. There is no discernable reason why this category of intermediaries should be privileged. On the contrary, it is essential that they are also subject to the requirements in articles 19 and 20 of the modified CCD-Proposal.

What is more, the definition should be based on the concept of "main activity". The word "habitually" should be deleted since it renders the definition too wide including simple suppliers acting as intermediaries in an ancillary capacity.



Thus, the definition in article 3 (e) of the modified CCD-Proposal (page 21) would read as follows:

“(e) “credit intermediary” means a natural or legal person who for a fee, which may take a pecuniary form or any other agreed form of financial consideration, as a main activity [...]”.

Finally and against the background of the Commission’s statement with respect to intermediaries in its White Paper on Financial Services Policy (2005-2010)⁴, the Federation would urge the European Institutions to adopt an approach which ensures consistency across sets of proposals for regulation in the area of intermediaries (e.g. the Directive 2002/92/EC of 9 December 2002 on Insurance Mediation).

3. Total Cost of the Credit and APRC

The Federation welcomes the narrowed approach to the calculation of the APRC in the modified CCD-Proposal. It has always maintained the position that only a narrow basis for the calculation would enable the APRC to fulfill its purpose of comparability (see the Position Paper dated 8 January 2003 mentioned above).

Indeed, comparability depends on the fact that the components of the APRC are the same throughout the Member States, so that when comparing APRCs the consumer is comparing a similar piece of information. As such, only a narrow APRC, limited to the costs levied by the lender for the loan for his benefit, and therefore similar throughout the Member States, can prove to be a useful tool of comparison for the consumer.

Against this background the definition of the APRC itself needs to be a narrow one. The concept of “total cost of the credit” should not be used as the basis for the calculation of the APRC since this could be misleading. Rather the total cost of the credit should be seen as additional, different information on costs which are not included in, but complement the APRC.

Finally, the EMF is of the opinion that the examples for the calculation of the APRC formerly given in Annex II of the Proposal should not be deleted. They constitute a guideline on how to interpret the mathematical formula contained in Annex I of the CCD-Proposal. As such, they ensure that the aforementioned formula will be interpreted in the same way throughout the Member States.

4. Linked Transactions and Joint and Several Liability

The EMF is of the opinion that the definition of linked credit agreements proposed by the Commission is not precise enough and could expose lenders to far-reaching liability risks. According to article 3 (I) (ii) of the modified CCD-Proposal a "commercial unit" between the credit agreement and the financing agreement - i.e. a linked credit agreement - will always exist if the lender and the supplier of the goods/services are two different entities and the lender uses the services of the supplier "in connection with the conclusion or preparation of the credit agreement". On the basis of this definition, any connection of any kind between

⁴ Paragraph 4.4.2., page 14 of the White Paper.



the company and the credit agreement would result in the credit agreement being classified as a "linked credit agreement". A mere mention by a supplier of a possible method of financing of the goods or services would, under the proposed definition, qualify the credit agreement concluded by the consumer as a "linked credit agreement" - even if there is no legal relationship between the lender and the supplier.

The Federation welcomes the fact that the issue of joint and several liability is left to the discretion of Member States. However, further clarification is needed with respect to the wording in article 14.2. of the modified CCD-Proposal (page 36). It should be made clear that subsections (a) to (e) constitute cumulative criteria.

5. Information Requirements

The Federation feels that with respect to the information requirements the modified CCD-Proposal is an improvement on the previous one. However, there is still room for further simplification, since the functioning of the different layers of required information could turn out to be difficult in practice.

6. Responsible Lending and Borrowing and Duty to Explain and to Assist

The EMF welcomes the fact that the duty to advise has been replaced by a duty to explain and to assist. Nevertheless, the Federation would like to take this opportunity to re-emphasise that the responsibility of the lender is to give complete, exact and adequate information to the consumer. Once the consumer has been appropriately informed, it is his responsibility to take the final decision as to which product best suits his needs. It is also his responsibility to assess that he will be able to meet his repayment obligations. This important principle was discussed and agreed upon with the Consumer Associations during the negotiations on the Code of Conduct. It is expressly mentioned in the Code.

Against this background, the obligation on Member States to ensure that creditors explain, where appropriate, the advantages and disadvantages of products proposed (see article 5.5. sentence 1 of the modified CCD-Proposal) should be suppressed. Clearly, whether a product is advantageous or not depends on a consumer's personal circumstances and the economic context at the time. Instead, the principle should be that the lender must explain the "features/characteristics of the product".

The Federation does not question the obligation for the lender to act responsibly and it supports the improvement and harmonisation of the information to be given by the lender to the consumer. However, it strongly opposes the introduction of any concept of responsible lending, which would result in a shifting of the responsibility for the final decision to the lender. Against this background Recital 20 (p. 14 of the modified CCD-Proposal) is misleading. The wording "most appropriate" in the first sentence of the aforementioned provision could be construed in such a way that the lender has to assist the borrower as to which product best fits his needs. This would imply a fundamental imbalance of responsibilities between the consumer and the professional. Indeed, it could ultimately amount to a duty to advise rather than a duty to assist.



Furthermore, the principle of responsible lending and borrowing is too subjective a concept to be endorsed in legislation because it is very difficult to assess and to prove. Such a provision would lead to a dramatic increase in litigation about responsibility.

Lenders' credit granting policy is decided and approved upon by their board and monitored by the supervisory authorities. In all Member States, consumers are entitled to expect that any professional with whom they deal will act responsibly and, in practice, no lender would grant a credit if he did not assume the capacity of the borrower to meet his repayment obligation. However, as already stated above, the final decision and responsibility is to be taken by the borrower and the lender cannot in any case be considered responsible for the borrower's possibly inappropriate decision.

In any case, general regulation of civil responsibility (which provides for a higher level of responsibility for professionals) existing in all Member States provides the right for the consumer to seek redress if this basic principle is infringed. In parallel, action can also be taken through the national out-of-court settlement schemes. There is therefore no need for one more level of responsibility, especially if it is based on an assumption, which would be made a posteriori. It could have the negative effect of limiting the offer of credit.

Finally and for the reasons given above, the EMF considers that the consumer should have a similar obligation to provide the lender with adequate information regarding his personal circumstances. Therefore the reference introduced in recital 19 of the CCD-Proposal (page 14), namely that consumers should also act with prudence and respect their contractual obligations, should be included in article 5.1. sentence 1 of the modified CCD-Proposal (page 25) in case the principle of responsible lending (and borrowing) is retained. The fact that article 5.1. sentence 2 of the CCD-Proposal states that the information provided by the consumer has to be "accurate" is not sufficient in this respect.

7. Consultation of National Databases

Furthermore, the Federation feels that the rule laid down in article 8.2. of the CCD-Proposal should be deleted since it is already largely dealt with in the Data Protection Directive.

8. Early Repayment

With respect to article 15.2. of the modified CCD-Proposal (page 37) the EMF would like to underline that the calculation of early repayment fees should be based on an objective calculation method that allows lenders to be fully compensated for their loss.

In addition, the Federation would like to question whether or not the exclusion of any indemnity in article 15.2. (a) of the CCD-Proposal (page 37) is justified. The lender incurs a loss if the fixed interest period is less than one year as well as if the relevant period is longer than one year. Moreover, it is not clear why this one year period was introduced. In Sweden, for example, credit agreements are considered fixed rate agreements if the period used to fix interest rates is longer than three months. The exclusions in article 15.2. sentence 2 should be deleted.



9. Implementing Measures

The EMF feels that further clarification is needed on how the new approach adopted by the Commission in the modified CCD-Proposal, i.e. the application of both full harmonisation and mutual recognition in one directive (see article 21, page 50), would work in practice.

10. Unfair Terms

The EMF is of the opinion that changes to the Directive on Unfair Terms in Consumer Contracts (93/13/EEC of 5 April 1993) should for consistency reasons be made within the aforementioned Directive in a separate procedure.

Thus, in line with the position of the European Parliament agreed upon in its plenary meeting on 20 April 2004 article 27 of the modified CCD-Proposal (page 54) should be deleted.