

# EU mortgage integration

**Kevin J Gillon**, a partner at Mishcon de Reya, discusses the White Paper on the Integration of EU Mortgage Credit Markets. He looks at the subject of early repayment, which the EU views as one of the most important issues in European mortgage integration

Following representations on the Green Paper on Mortgage Credit in the EU published on 19 July 2005 the European Commission appears to be going its own way in the proposals put forward in the White Paper on the Integration of EU Mortgage Credit Markets recently published on 18 December 2007.

The Commission has been influenced by the problems in the sub-prime market in the US and refers to the dangers of irresponsible lending and mis-selling and indeed to unscrupulous credit intermediaries. They claimed the content of the White Paper is not just a response to this turmoil but has wider implications.

## Treaty

The Commission states it has not yet decided if legislation is the best way forward to implement the White Paper proposals; the normal way of proceeding with this would be through a directive, which would have a direct effect on each member state requiring them to enact local legislation. The Commission emphasises that consideration will be given to the attendant costs of any such legislation.

As a primary source, though, any such legislation would be enacted as a result of the following Articles in the Treaty Establishing the European Community:

- **Article 3** – “an internal market characterised by the abolition, as between member states, of obstacles to the free movements of goods, persons, services and capital”.
- **Article 14** – “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 a provision of the Treaty”.
- **Articles 47(2) and 95** make it clear that directives are to be used for the approximation of laws, regulations or administrative provisions of the member states.

## Objectives

The stated objectives in the White Paper are:

1. Facilitating cross-border supply and funding of mortgage credit. This is to be achieved by removing the legal and economic barriers currently restricting cross-border and preventing pan-EU funding in a cost-efficient way.



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2. Increasing product diversity. There is no lack of mortgage products but none of the member states has a complete range of products. This is in part due to the consumer market but also to legal barriers. The Commission wants to see new products throughout the EU but at the same time protecting the consumer and ensuring financial stability.
3. Improving consumer confidence. Again consumer protection is the key ingredient here. Consumers should not be bound by location, and high-level advice including legal advice should always be available.
4. Facilitating customer mobility will address the restraints placed on borrowers, both financial and legal, when they switch lenders. This has a direct effect on competition and can involve tying the borrower into practices such as linking to a current account, no choice in insurance policies and insisting on payment of salary to a linked account.
5. To achieve success in meeting these objectives the Commission identifies as key areas – pre-contractual information; Annual Percentage Rate Charge (APRC); responsible lending; early repayment. This paper will explore the question of early repayment as the Commission clearly views this as one of the most important issues in the integration of the EU mortgage market.

## The percentage game

The Commission was undoubtedly influenced by the various assessments in the percentage terms relating to mortgage products and their availability in the member state. HYPOSTAT 2005 states that no less than 47 per cent of EU GDP is represented by some EUR 5.1 trillion residential mortgage loans, but the national markets vary enormously; in the UK it stands at EUR 1.4 trillion. Mortgage debt itself as a percentage of GDP varies from 97 per cent

## Executive Summary

- The European Commission has not yet decided if legislation is the best way forward to implement mortgage integration. Consideration would be given to the costs.
- Objectives in the White Paper include: cross-border supply and funding of mortgage credit; increasing product diversity; improving consumer confidence; and considering customer mobility.
- The Commission identifies as key areas: pre-contractual information; Annual Percentage Rate Charge (APRC); responsible lending; and early repayment, which the Commission views as one of the most important issues in the integration of the EU mortgage market.
- There is virtually no take-up of cross-border mortgage products. Only 3 per cent of consumers across Europe would consider a mortgage from another member state; in the UK the figure is higher at 9 per cent.
- During 2008 the Commission will explore with member states and the European Parliament options for early repayment and the cost and benefits involved.
- The Commission sees vastly differing rules as imposing unnecessary restrictions on cross-border lending; this prevents product diversity and choice, and curtails demand.



in the Netherlands to 5 per cent in Slovenia. Owner occupation fluctuates widely also, from 97.9 per cent in Lithuania to 43.2 per cent in Germany (the UK is on 71 per cent).

Will borrowers be prepared to cross borders to purchase mortgage products? Although in a five-year period second homes in another jurisdiction increased by some 45 per cent, there is virtually no take-up of cross-border products. Borrowers continue to shop locally for their mortgage product but a number of consumers indicate that they would consider a mortgage from a different jurisdiction in the future; in the case of UK consumers the figure is high at 9 per cent. Many reasons hold back this market, including the misconception that it is not possible to obtain a mortgage outside one's own jurisdiction, lack of information and poor legal protection. The average number of consumers throughout the EU who would consider a mortgage product from another member state in the future is very low at only 3 per cent.

### Early repayment

So, why does the Commission consider the question of early repayment of such fundamental importance in preventing mortgage integration throughout the EU? During the year 2008 it will examine and explore with the member states and the European Parliament possible policy options for early repayment and the cost and benefits relating to the different options. It is seen that competition is influenced by the possibility of high costs in switching mortgages by the consumer.

The regimes for payment of mortgages differ throughout Europe; for example, there may be a legal right to

redeem at any time by legislation or complete freedom to negotiate terms relating to the same, and there can be variations on this as to a set time when repayment can be made or imposing certain conditions. There can be legislation to prevent or restrict the right of the lender to compensation for early repayment either in any circumstances or in certain circumstances; the UK of course has the contractual option as to early repayment.

The Commission sees these vastly differing rules as imposing unnecessary restrictions on cross-border lending; they prevent product diversity and choice and curtail consumer demand. In addition the lack of common rules prevents mortgage lenders entering different markets. Consumers are also rightly concerned as to what rules would apply to them, i.e. a consumer in the jurisdiction with no fetter at all on early redemption would not want to borrow in the jurisdiction with an unrestricted contractual option. To the Commission both consumers and mortgage lenders are adversely affected by the differing rules.

Naturally consumers would favour a full right to early repayment without restrictions but most would agree the lender should receive what is a fair compensation but on a capped basis. On the other hand mortgage lenders in the main not unsurprisingly favour full and complete contractual freedom. They are particularly concerned over the prospect of financial risk if the economic climate dictated that vast numbers of borrowers would simultaneously redeem in a market where interest rates were falling. Aside from a capping provision the mortgage lenders are in favour of repayment fees being harmonised. The member states are divided at this time in their

views except that there should be some compensation to the lender.

### Options

What are the options to be considered?

1. There is the possibility of nothing being done, this would leave the market with a situation whereby considerable time and expense would have been expended in examining ways to improve cross-border mortgages to no avail.
2. Similarly self-regulation would do little to change the present situation and as there are real difficulties in reaching self-regulation this has been ruled out at this stage.
3. There can be legislation to grant liberalisation of early repayment regimes – the contractual option. This can take the form of a full right to early repayment but allowing consumers to agree to waive this right; this would give flexibility to both consumers and lenders. There could be caps on compensation payable to the lender or other constraints.
4. The contractual option can be allied with the right to redeem early in certain circumstances; this would liberalise the current situation. In addition there could be rights to redeem under circumstances which override that in the facility, for example unemployment.
5. The right could be granted by way of compulsory right to early repayment. This could be allied to limiting costs to those actually incurred by the lender or by capping.
6. Finally, there could be legislation to provide for the mutual recognition of the various regimes so that each member state's regimes are not altered.

Clearly the Commission favours options 4 and 5 above and equally clearly this would require legislation to implement. This will need a comprehensive qualitative and quantitative study to evaluate their effect.

### Conclusion

Whether we will have a directive or not will depend on the future analysis by the Commission with the member states and the European Parliament during 2008. In particular projected costs will be set against benefits, but with estimates of a substantial interest saving due to an integrated mortgage market together with the ability to access a much wider range of products this must be seen as a distinct possibility. **MFG**