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COMMISSION STAFF WORKING PAPER

IMPACT ASSESSMENT

Accompanying document to the

**Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on credit agreements relating to residential property**

(Text with EEA relevance)

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1. INTRODUCTION

The financial crisis had a substantial impact on EU citizens. Although an important contributing factor was the growth in securitisation, which allowed creditors¹ to pass the risk of their lending portfolios to investors, consumers have faced the consequences first hand. Many have lost confidence in the financial sector and certain lending practices that used to prevail are now having a direct impact.² As borrowers have found their loans increasingly unaffordable, defaults and foreclosures have risen. Addressing irresponsible lending and borrowing is therefore an important element in financial reform efforts.

The focus on mortgage markets is not new. For several years, the Commission has reviewed EU residential mortgages markets to ensure the efficient functioning of the Single Market. This review has identified areas of work of direct relevance to responsible lending and borrowing (e.g. pre-contractual information, advice, assessment of creditworthiness, and credit intermediation) as being barriers to the efficient functioning of the Single Market.

In view of the problems brought to light in the financial crisis and efforts to ensure an efficient and competitive single market, the Commission undertook to present measures on responsible lending and borrowing, including a reliable framework on credit intermediation.³ In this respect, responsible lending is care taken by creditors and intermediaries to lend amounts that consumers can afford. It means that the credit products offered are appropriate and affordable for consumers. This may be obtained through an appropriate framework in place to ensure that all actors act in a fair, honest and professional manner. Responsible borrowing implies that consumers should provide relevant, complete and accurate information on their financial conditions, and make informed and sustainable borrowing decisions.

In line with the Commission's better regulation approach, policy orientations need to be carefully considered and their impact thoroughly assessed beforehand. Accordingly, this report identifies problems in EU mortgage markets, in particular those associated with irresponsible lending and borrowing at the pre-contractual stage (advertising and marketing, pre-contractual information, suitability and creditworthiness assessments, advice) and the potential scope for irresponsible behaviour by credit intermediaries and non-credit institutions providing mortgage credits (NCIs). Other issues such as low levels of financial literacy, the tying of mortgage credit products to other products, and issues relating to mortgage funding, which may also impact on the decision to grant a particular credit and the borrower's choice of mortgage product, are out of scope of this initiative.

¹ Creditors are defined as credit institutions and non-credit institutions.

² E.g. foreign currency lending, self-certified mortgages.

³ COM(2009) 114, 4.3.2009.

2. PROCEDURAL ISSUES

2.1. Consultations and studies

The Commission has undertaken a review of EU Mortgage Markets, culminating in the *White Paper on the Integration of EU Mortgage Markets*.⁴ This process forms an integral part of the preparatory work for this initiative. Against this background and in the wake of the financial crisis, the Commission launched a public consultation on 15 June 2009 to strengthen and deepen its understanding of the issues surrounding responsible lending and borrowing, culminating in a public hearing on 3 September 2009.⁵ Extensive feedback has also been received through formal and informal channels. The European Parliament and European Economic and Social Committee have adopted several reports on related issues.⁶ At Member State level, the Government Expert Group on Mortgage Credit and the Government Expert Group on Retail Financial Services discussed the issue on several occasions. Consumer representatives were consulted via the Financial Services Consumer Group in September 2009. In addition, financial services users were consulted via FIN-USE, who produced several related reports.⁷ Consultative meetings were held with numerous other stakeholders including UNI-Europa in May and November 2009, and other stakeholders including banking associations and financial service providers. Informal consultations also took place with Member States, consumer representatives, social partners (including trade union representatives), creditor and credit intermediary representatives and credit registers in September 2010. A number of external studies have been undertaken to establish the baseline⁸ and to assess the costs and benefits of different policy options⁹.

2.2. Impact Assessment

2.2.1. Impact Assessment Steering Group

An Interservice Impact Assessment Steering Group was established in October 2009. It was chaired by DG Internal Market and Services and had representatives of DG Health and Consumers, DG Enterprise and Industry, DG Competition, DG Economic and Financial Affairs, DG Employment, DG Justice and the Secretariat General; the ECB also participated. It met on 23 October 2009, 11 December 2009 and 13 July 2010.

⁴ COM(2007) 807, 18.12.2007.

⁵ See http://ec.europa.eu/internal_market/finservices-retail/credit/responsible_lending_en.htm.

⁶ *Report on Mortgage Credit in the EU*, A6-0370/2006; *Report on the Green Paper on Retail Financial Services*, A6-0187/2008; *Resolution on Competition: Sector Inquiry on Retail Banking*, P6_TA(2008)0260; *Opinion on the Green Paper on Mortgage Credit in the EU*, 15.2.2005; *Report on the White Paper on the integration of EU Mortgage Credit Markets*, 3.2.2009.

⁷ See http://ec.europa.eu/internal_market/fin-use_forum/documents/index_en.htm.

⁸ E.g. *Study on Credit Intermediaries in the Internal Market*, Europe Economics, January 2009; *Study on the role and regulation of non-credit institutions in EU mortgage markets*, London Economics, December 2008.

⁹ *Study on the costs and benefits of different policy options for mortgage credit*, London Economics with Achim Dübél (Finpolconsult) in association with the institute für finanzdienstleistungen (iff), November 2009.

2.2.2. Opinion of the Impact Assessment Board

The report was presented to the Board on 22 September 2010 and the Board adopted its Opinion on 24 September 2010. It concluded that the report provides the necessary evidence base for action and focused on four main recommendations to improve the Report. These recommendations have been incorporated into a revised version of the Report.

The Board recommended providing an explicit definition of responsible lending and borrowing (see Section 1) as well as strengthening the analysis of the problem description to clarify the magnitude of the problem (see Section 3.1), qualifying its relevance relative to other causes of the financial crisis (see Section 3.2), and assessing the importance of the specific drivers addressed by the initiative in question. An analysis of the potential spill-over effects of irresponsible lending and borrowing on the macroeconomy has been introduced (see Section 3.4). The Board also suggested strengthening the analysis of subsidiarity and proportionality, in particular the consumer protection and financial stability angles (see Section 5). The Board requested that the analysis of the impacts was further developed, in particular by qualifying the biases in the estimations (see Section 6.1 and Annex 5), and the analysis of the principles-based guidance on remuneration schemes (in the Report and Annex 4) and the impact of reduced access for low income households (throughout the Report and Annexes 4 and 5). Finally, the Board suggested possible ways to reduce the length of the text and possible ways to improve the presentation of the impact assessment report. Presentational considerations have been integrated and every effort has been made to reduce the length of the Report while at the same time integrating the comments received.

2.3. Main findings of consultations

The extensive consultation process has allowed the identification of some key messages. First, the banking industry argues that irresponsible lending does not exist in the EU to the same extent as in the US, thus, there is no need for EU intervention. This report acknowledges that problems in EU mortgage markets have not been as widespread as in the US, but points to the fact that similar weaknesses in the regulation of EU markets have been identified, e.g. a lack of effective regulation of certain actors and weaknesses in the regulation of the mortgage marketing and sales processes. Second, consumer representatives are supportive of an initiative that will ensure a high level of consumer protection and that could prevent overindebtedness. They are also supportive of measures that would allow consumers to compare offers and that will give consumers confidence in the actors with whom they engage. They favour an EU level proposal which would introduce only minimum standards, leaving Member States free to enhance consumer protection in line with local conditions and culture. Third, given the current small market for cross-border mortgages, some stakeholders argue that it would be more appropriate for measures to be taken at the national rather than the EU level. Three of the issues for which there was the most consistent cross-stakeholder support for EU action were the obligation to undertake a creditworthiness assessment, the need for clear, comprehensible and comparable pre-contractual information and the need to ensure that all players in the lending market are subject to appropriate regulation and supervision.

3. PROBLEM DEFINITION

3.1. Introduction

Irresponsible lending and borrowing can be found throughout the EU. Rising household debt levels exist throughout Europe, of which mortgage debt is the largest component, accounting for some 70 % of euro area households' total financial liabilities at the end of 2008.¹⁰ High household debt levels are not in themselves a sign of irresponsible lending and borrowing, as long as the levels of debt are sustainable and repayments can be met. However, figures show that citizens are having increasing difficulties in meeting their debt commitments. Research shows that, in 2008, 16 % of people reported difficulties with paying bills¹¹ and 10 % of all households reported arrears¹². The difficulties faced by households in meeting their debt repayments has led to an increase in default rates in all EU Member States since 2007: between end 2007 and end 2009 while default rates in France, Portugal, and the UK rose only slightly, default rates in Cyprus, Hungary, and Poland more than doubled and in Ireland, tripled. Default rates in Denmark, Spain, Estonia, Bulgaria and Latvia all increased more than threefold. Similarly, a rise in foreclosures can be observed in a number of Member States.

Data can be influenced by factors other than irresponsible lending and borrowing such as the general economic downturn. However, when the data is combined with qualitative evidence provided both in Section 3 and in Annexes 1 and 4 through stakeholders' contributions and anecdotal evidence from across Europe it can be seen that the identified problems are not just a result of the conjuncture. For example, risky products such as mortgages provided in foreign currency are prevalent amongst new Member States, with more than 90 % of mortgages in Latvia, Romania and Estonia being issued in a foreign currency. This problem is not however limited to the new Member States: in Austria, more than 38 % of outstanding mortgage credit is denominated in a foreign currency. In Spain, house price to income and loan to income ratios both broadly doubled between 2002 and 2007 and in Germany, loan-to-value standards were more relaxed in the early 2000s: at its peak, 20 % of new lending was above 100 %.¹³ Irresponsible lending and borrowing in the EU is not however on the same scale as in the US. Not only do fewer EU citizens in general have mortgages (only 20 % of euro area households have a mortgage compared to 45 % in the US) but those mortgages are less targeted at the most vulnerable groups in society (the share of low income households with mortgages in the US is 16 % compared to 4 % in the euro area).¹⁴

The financial crisis itself has also shaken lending markets, leading them to self-correct and act in a more responsible manner, providing mortgage credit that individuals can afford and are suitable. In the midst of the financial crisis, higher equity mortgages (e.g. loans with higher loan-to-value ratios) and some forms of interest rate contracts became difficult to obtain. For example, in February 2009 in the UK there were 1 542 different home loans available compared with 15 599 in July 2007: only three products were available for a deposit of 5 % (compared to 1 079 in July 2007) and 113 required 10 % deposit; no variable-rate self-

¹⁰ Monthly Bulletin, European Central Bank, August 2009, p. 78.

¹¹ *Europeans' state of mind*, Eurobarometer 69, November 2008, p. 39.

¹² *Towards a Common Operational European Definition of Over-indebtedness*, Observatoire de l'épargne Européenne in cooperation with CEPS and the University of Bristol, February 2008, p. 10.

¹³ See footnote 9, pp. 397 and 399.

¹⁴ Monthly Bulletin, European Central Bank, March 2009.

certification deals were available; the maximum loan to value ratios lenders would advance on fixed-rate products was 75 %.¹⁵ However, although many of the riskier products disappeared from the market during 2007/2008, anecdotal evidence appears to show that the flight to safety was temporary. Evidence from Spain and France shows that loans with high loan-to-value ratios (in excess of 90 %) which were widely available in the EU before the financial crisis, are increasingly available again.

3.2. Drivers of irresponsible lending and borrowing

A range of factors drive the decision to grant a particular mortgage credit to a consumer and the borrower's ongoing ability to repay the loan.

3.2.1. General economic climate

As described above irresponsible lending and borrowing activities can have a severe impact on the economy. Conversely, the economy can also influence a borrower's ability to repay. Arrears, defaults and foreclosures all rise during an economic downturn as a borrower's ability to repay their mortgage is put in question, for example, through unemployment.

3.2.2. Market failures

Market failures occur when the interests of creditors, credit intermediaries or consumers lead to a sub-optimal outcome. In this case, the interests of creditors and credit intermediaries to make a profit and the interests of borrowers to get a loan at the cheapest rate may lead to irresponsible borrowing and lending. Market failures in EU mortgage markets fall into two general categories: information asymmetries and misaligned incentives (conflicts of interest). With regard to information asymmetry, a creditor or credit intermediary is usually better informed than a consumer about the features of a mortgage product. In contrast, a borrower is better informed than a creditor or credit intermediary about his/her own personal and financial situation. Conflicts of interest can also lead to market failure. For instance, creditors or credit intermediaries' interests may be skewed by their remuneration structures, which may lead to the provision of inappropriate products to the borrower. Likewise, a creditors' interest to provide a loan and make a profit and the borrower's interest in purchasing a property may lead to inadequate creditworthiness or suitability assessments.

3.2.3. Regulatory failures

Regulation is often introduced to address market failures, such as those described in the previous section. But regulation that is ineffective, inconsistent, or in some cases, non-existent, can lead to inefficient outcomes.

Gaps and/or inconsistencies in the regulatory framework for non-credit institutions providing mortgage credit (NCIs) and/or credit intermediaries can create an unlevel playing field between market actors and potentially lead to regulatory arbitrage. At the EU level, only credit institutions, unlike NCIs and credit intermediaries, are regulated and subject to authorisation, registration and supervision requirements¹⁶. At Member State level, NCIs are

¹⁵ *Slump in number of mortgage products on offer*, The Independent, 9.2.2009. Based on data from Moneyfacts.co.uk.

¹⁶ Directive 2006/48/EC, 14.6.2006.

not regulated in some but subject to more developed legislation in others¹⁷. Likewise, the registration, authorisation and supervision of credit intermediaries ranges from light-touch regimes to more advanced rules.¹⁸ In the US, mortgage brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 % of subprime mortgages¹⁹. This inadequate regulatory coverage and potential for wider implications led to the G20 recommendations (see Section 6.9.5 for more information), "that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances"²⁰. Contrary to these recommendations, both at the EU and national level, not all mortgage market participants are regulated or subject to oversight.

Mortgage conduct of business regulation at the EU and Member State level is patchy and inconsistent. Pre-contractual information is covered by an *EU Voluntary Code of Conduct on Pre-contractual information for Home Loans* (the Code) which is implemented to varying degrees.²¹ Misleading advertising is covered by the Directive on misleading advertising²² and the Directive on Unfair Commercial Practices²³, but these do not take into account the specificities of mortgage credit nor address the need for consumers to be able to compare adverts. The riskiness of mortgage loans is taken into account the Capital Requirements Directive²⁴ (CRD) but in a way that manages lenders' rather than a borrowers' risks.

Although many Member States are already taking action to protect consumers in the field of mortgage credit, their approaches are diverse, reducing the single market and erecting new barriers to cross-border activity by creditors and consumers alike. A large number of Member States apply or intend to apply selected provisions of the Consumer Credit Directive²⁵ (CCD), which covers consumer credit loans from EUR 200 to EUR 75 000 and regulates pre-contractual and contractual information, creditworthiness assessments, adequate explanations and disclosure requirements for credit intermediaries, to mortgage credit.²⁶ In addition, a number of Member States, such as the UK and Germany, are actively developing detailed proposals in the area of mortgage credit. Such regulatory efforts at national level contribute to the regulatory patchwork across the EU and further exacerbate the current fragmentation of EU mortgage markets. One example of measures increasing the fragmentation of EU markets are the recent Hungarian measures to protect consumers against the risk of foreign currency loans, which forbid mortgages in foreign currency from being entered into the land register. However, it should be underlined that not all Member States have initiatives underway to address the proven market and regulatory failures. As a consequence, regulatory gaps and market failures remain. For example, although self-certified mortgages existed in several EU Member States prior to the financial crisis, based on the information currently available to Commission services, only the UK is considering acting to address their deficiencies.²⁷

¹⁷ See Annex 4, Section 6.2.

¹⁸ See Annex 4, Section 5.2.2.

¹⁹ *Treasury Blueprint for a modernised financial regulatory structure*, 31.3.2008, p. 6.

²⁰ *G20 Declaration, summit on financial markets and the world economy*, 15.11.2008.

²¹ *Agreement on a voluntary Code of Conduct on pre-contractual information for home loans*, 5.3.2001.

²² Directive 2006/114/EC, 12.12.2006.

²³ Directive 2005/29/EC, 11.5.2005.

²⁴ Directive 2006/49/EC, 14.6.2006.

²⁵ Directive 2008/48/EC, 23.4.2008.

²⁶ See Annex 3.

²⁷ See Annex 1, Table 1 and *CPI0/16: Mortgage Market Review*, Financial Services Authority, 13.7.2010.

3.2.4. Other factors

Market failures are further exacerbated by low levels of financial literacy. A survey carried out in France, Spain and Italy showed that a large proportion of people on low incomes were not able to evaluate costs and terms.²⁸ Borrowers with low levels of financial literacy may not fully understand the information or explanations provided to them. Consequently, they may find themselves choosing an unsuitable product and thus being in the position of being unable to repay the loan. Efforts to improve financial literacy are an essential foundation in building a framework for responsible borrowing. In this respect, ongoing efforts in Member States and Commission initiatives undertaken in the wake of its 2007 Communication aim to improve levels of financial literacy.

Mortgage financing, as was seen during the financial crisis, can have a significant impact on lending decisions. The originate and distribute model of mortgage financing (securitisation) and the level of capital that creditors were required to put aside to cover risks also had an impact on the level of risks that lenders were willing to take on. Creditors were willing to take on greater levels of risk in the knowledge that those risks could be passed on, at no cost to them. In this respect, the reviews of the CRD (CRD II and CRD III) sought to address these risks.

Finally, other, unforeseeable factors can also influence a borrowers' ability to repay a loan. Factors such as divorce, unemployment or death can all have an impact.

3.2.5. Conclusion

While factors such as the general economic downturn, as well as 'other factors' mentioned above are important, they are not the only factors responsible for identified problems and notably for the fact that irresponsible behaviour by certain market actors was at the source of the financial crisis. It is therefore clear that irresponsible lending practices need to be addressed at EU level to avoid a repeat of the current financial crisis.

3.3. Specific problems

Seven core problems have been identified. Six of these are summarised below.

In addition to the six problems described below, the different rules on when and under what circumstances consumers can repay early as well as the different rules on the compensation chargeable in the event of early repayment have been previously identified as a problem. This problem is described in detail in the impact assessment accompanying the *White Paper on the Integration of EU Mortgage Loans*²⁹.

3.3.1. Non-comparable, unbalanced, incomplete and unclear advertising

Consumers risk being misled by unbalanced or unclear advertising practices. Cases of inappropriate advertising can be found throughout the EU.³⁰ In many cases, the advertising is targeted at low-income, overindebted, or credit-impaired households. Incomplete and unclear

²⁸ *Access to Credit: the Difficulties of Households, New Frontiers in Banking Services: Emerging Needs and Tailored Products for Untapped Markets*, Neri, 2006.

²⁹ SEC(2007) 1683, Annex III, p. 55-80 and corresponding IAB Opinion, SEC(2007) 1685.

³⁰ See Annex 4, Section 1.3.

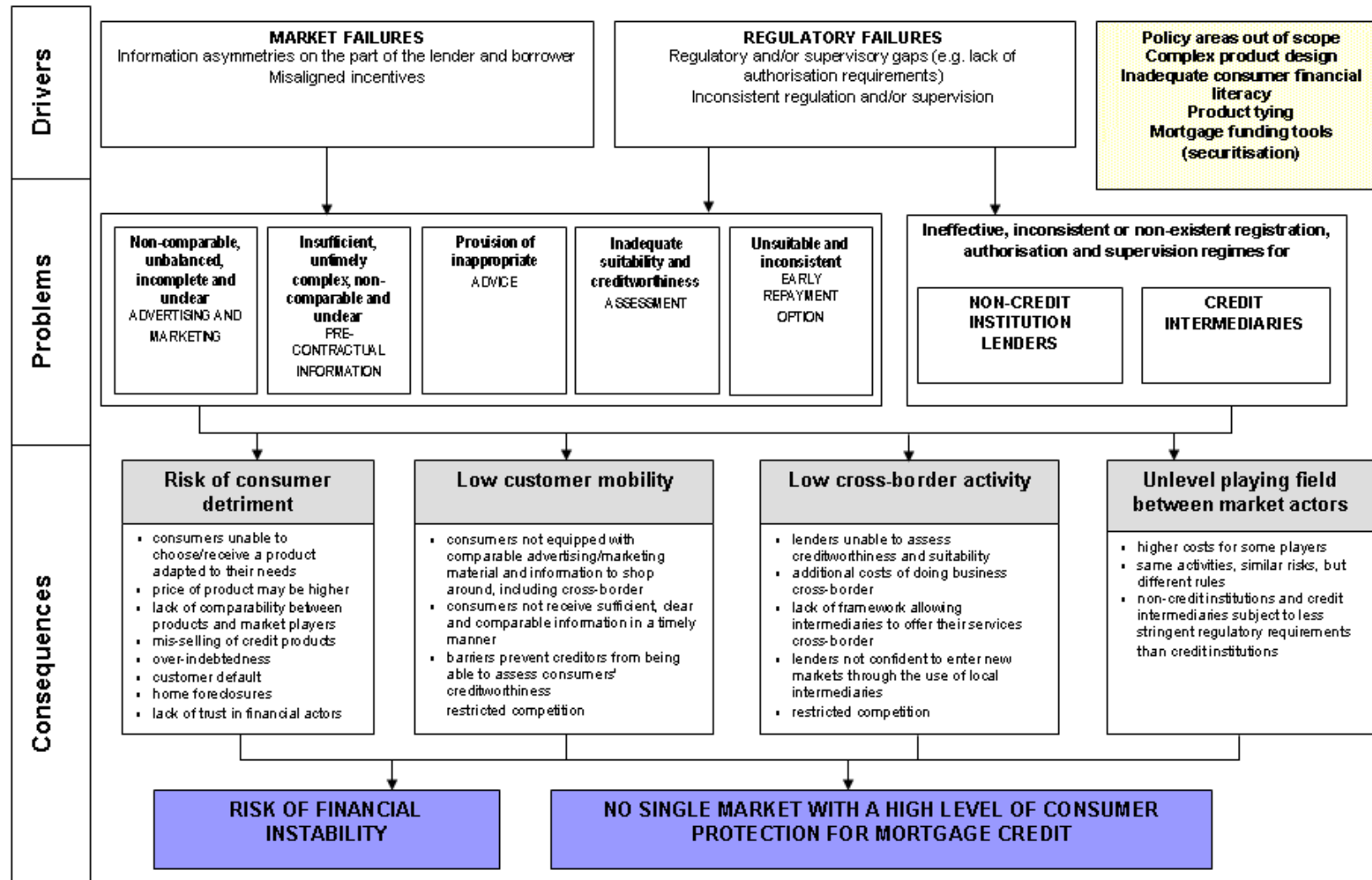
advertising and marketing material is also difficult to compare.³¹ Consumers, particularly those with low levels of financial literacy, not only find it hard to decide which credit product marketed is the most advantageous, but may also conclude that a particular product is more advantageous or appropriate for them when in fact it is not.

Despite national legislation and EU rules forbidding misleading advertising, inconsistencies and gaps exist. While some Member States³² will apply the rules of CCD to mortgage credit, others will not. This means that advertising and marketing materials will remain incomparable for those consumers wishing to shop around and those creditors and/or credit intermediaries offering products and services cross-border will face a multiple burden.

³¹ See Annex 4, Section 1.

³² See Annex 4, Section 1.2.2.

PROBLEM TREE: RESPONSIBLE LENDING AND BORROWING



3.3.2. *Insufficient, untimely, complex, non-comparable and unclear pre-contractual information*

The provision of pre-contractual information allows the consumer to understand the features and risks of a certain product and to compare products to make an informed choice.

Efforts have been made to address regulatory and market failures.³³ But application of the Code has been mixed and enforcement and monitoring mechanisms ineffective.³⁴ Although adherence and implementation of the Code in some markets is close to 100 %, in other markets it is less satisfactory.³⁵ Moreover, the Code applies only to creditors and places no obligations on credit intermediaries. Anecdotal evidence shows that credit intermediaries have also exploited information asymmetries.³⁶ Finally, the timing of provision of the European Standardised Information Sheet (ESIS)³⁷ varies, limiting its use; in the mortgage application process only 7 % of consumers were given an ESIS in an early meeting.³⁸

Market failures still remain. First, pre-contractual information is difficult to compare; almost 38 % of EU citizens find it very or fairly difficult to compare offers³⁹. Different methodologies and cost bases also make the Annual Percentage Rate of Charge (APRC) incomparable.⁴⁰ Second, consumers view the information provided as complex and unclear; 59 % of EU citizens found it difficult to understand information on the way their mortgages work and the risks involved.⁴¹ Third, the information provided is often incomplete; for instance, research established the need for clear warnings on the risks.⁴² Furthermore, there are no rules governing the disclosure of information on incentives structures and amount paid by the creditor to the credit intermediary. As such, the borrower is not in a position to understand if the information provided may be biased in favour of a creditor or product.

3.3.3. *Provision of inappropriate advice*

Advice is the provision of a personal recommendation for a consumer on suitable products. Independent advice is important for borrowers, particularly vulnerable borrowers, given the ever growing complexity of products, the large number of products and providers, and since many potential borrowers do not possess an adequate level of financial literacy.

Misaligned incentives in the provision of advice can lead to market failure. Advisors may face disincentives to provide impartial advice, e.g. because they have different levels of remuneration from different providers for the sale of different products. Inappropriate mortgage advice has been given in several cases, leading to consumer detriment⁴³.

³³ See footnote 21.

³⁴ COM(2007) 807, 18.12.2007, p. 6.

³⁵ See Annex 4, Section 2.2.1, Table 6.

³⁶ See Annex 4, Section 3.2.2.

³⁷ The ESIS gives product information in a standardised content and format.

³⁸ See footnote 9, Household Survey Annex.

³⁹ *Consumers' views on switching service providers*, Annex tables, Flash Eurobarometer 243, January 2009, p. 40.

⁴⁰ See Annex 4, Section 2.

⁴¹ *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005, pp. 67-69.

⁴² *Consumer Testing of Possible New Format and Content for the ESIS on Home Loans*, September 2009, p. 19.

⁴³ See Annex 4, Section 3.3.1.

The absence of regulatory guidance can also lead to regulatory failures. At the EU level, there is a lack of clarity on the liability for unsuitable advice. In the absence of rules or standards against which the provision of advice can be assessed, it is difficult to determine whether the advice given was appropriate. Standards also provide for access to redress, thus without such standards, access to redress is likely to be difficult. Evidence from Member States that do have advice standards in place shows how consumers who have received inappropriate advice were able to obtain redress by demonstrating to a financial ombudsman non-adherence to the standards.⁴⁴ In most Member States, no rules or standards on the provision of advice exist⁴⁵. In the remaining, the legal framework differs considerably due to different rules, level of detail and prescription, etc. It follows that there are distortions in legal certainty and clarity concerning liability for inappropriate advice across the EU.

3.3.4. *Inadequate suitability and creditworthiness assessment*

Assessing creditworthiness ensures that a borrower has sufficient capacity to repay the loan. Assessing the suitability of a product for a particular borrower ensures that the product is appropriate to borrowers' needs and circumstances. Credit institutions must have provisions that are commensurate with the risks they undertake.⁴⁶ It is argued that this – combined with the fact that creditors seek to avoid damaging and expensive defaults, write-offs and lengthy and/or expensive foreclosure procedures – means that most creditors act responsibly. Nevertheless, assessments of creditworthiness and suitability often remain inadequate.

There is a lack of incentives to undertake thorough creditworthiness and/or suitability assessments. Creditors may decide instead to rely on the value of the underlying collateral (mortgage), transfer the risk of default or sell the loan to a third party.⁴⁷ Conflicts of interest (e.g. remuneration structures) may also influence the decision to sell a particular product. Consumers may also have an incentive to overstate their income to obtain the loan and/or a better interest rate. Another market failure is the inability to access reliable information on a borrower. While information can be obtained directly from the borrower, information provided by consumers can sometimes be unreliable, especially given potential misaligned incentives. For example, consumers have been found to overestimate their income and/or underestimate their commitments in up to 70 % of mortgage applications.⁴⁸

A regulatory patchwork also exists regarding consumers' obligations to disclose information.⁴⁹ It may be unclear to consumers what types of information may be useful and what information should be disclosed. Inexistent, unclear or inconsistent frameworks also fail to clarify what is required for a creditworthiness or suitability assessment. Regulatory barriers also inhibit or prevent the ability of creditors to access information on a borrower's creditworthiness via a credit database, in particular cross-border. Even if credit databases can be accessed, there is no guarantee that the data available is sufficient to perform a creditworthiness assessment as credit registers differ in their services and in data content⁵⁰.

⁴⁴ See Annex 4, Section 3.3.2.

⁴⁵ Minimum advice standards exist in the United Kingdom, Ireland and the Netherlands.

⁴⁶ See footnote 24.

⁴⁷ See for instance, remarks at the Hearing on Responsible Lending and Borrowing, http://158.166.80.19:8080/internal_market/finservices-retail/docs/credit/resp_lending/summary_en.pdf.

⁴⁸ Response to the Financial Services Authority Mortgage Market Review Discussion Paper, Experian, December 2009, p. 10.

⁴⁹ See Annex 4, Section 4.

⁵⁰ *Report on the Expert Group on Credit Histories*, European Commission, 2009.

3.3.5. *Ineffective, inconsistent or non-existent registration, authorisation and supervision regimes for credit intermediaries and NCIs*

Registration and authorisation requirements enable public authorities to control the actors are active on a market and impose conditions for the business they engage in. Such requirements are also necessary to ensure effective prudential and conduct of business supervision. Consequently, gaps in or the absence of any regulation of the registration, authorisation and supervision of credit intermediaries and NCIs have the potential to create wider market failure. Although mortgage mis-selling practices by credit intermediaries and NCIs have been less prevalent in the EU than in the US⁵¹, similar regulatory and supervisory gaps (described in the following sections), and thus the potential risks of such practices exist in the EU.

3.3.5.1. Credit intermediaries

Not all Member States require credit intermediaries to be registered with or authorised by a competent authority (at least for the specific activity of credit intermediation)⁵². In Member States where there is no requirement there is the potential for irresponsible behaviour. Moreover, in many Member States⁵³ there are no professional requirements for credit intermediaries, thus their professionalism cannot be assured. Furthermore, the lack of registration or authorisation requirements means that authorities have little scope for supervision or are unable to impose sanctions for misconduct, potentially creating an uncompetitive environment in which misconduct, excessive risk taking or poor advice is not held to account. In addition, credit intermediaries' clients do not always have the right to receive redress in the event of a dispute regarding poor advice by the credit intermediary.⁵⁴ Similarly, the lack of prudential requirements for engaging in credit intermediation in 21 Member States can lead to an overly fluid and unreliable business.⁵⁵ Even in Member States with registered, authorised and supervised credit intermediaries, such as the UK, the regulatory framework has proved to be ineffective in some instances.⁵⁶ In particular, the UK review found evidence of individuals responsible for unsuitable mortgage sales moving between firms.

The problems are compounded when considering cross-border business. Cross-border activity is extremely limited at present⁵⁷: the regulatory patchwork can inhibit a business's decision whether to engage in cross-border business. However, a recent survey showed that cross-border activity by credit intermediaries would increase in importance as a distribution channel over the next five years, as would the level of cross-border trade. 25 % of companies surveyed expressed an interest in using credit intermediaries to engage in cross-border activity.⁵⁸

⁵¹ Brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 % of subprime mortgages in the US. Source: *Treasury Blueprint for a modernised financial regulatory structure*, 31.3.2008, p. 6.

⁵² See Annex 4, Section 5.

⁵³ See footnote 52.

⁵⁴ See Annex 4, Section 5.3.2.

⁵⁵ See footnote 54.

⁵⁶ E.g. UK Financial Service Authority, DP09/3 Mortgage Market review, October 2009, p. 66.

⁵⁷ *Study on Credit Intermediaries in the Internal Market*, Europe Economics, January 2009, p. 129.

⁵⁸ See footnote 57, p. 261.

3.3.5.2. Non-credit institutions providing mortgage credit

Six Member States⁵⁹ have no registration and authorisation requirements, and requirements vary widely between the other Member States. The lack of registration or authorisation requirements means that authorities have little basis for the supervision of NCIs' activities or for requiring sanctions for misconduct. Even if the current market share of NCIs is low in some Member States, evidence has shown that market shares can rise and fall rapidly, with considerable impact even in markets with requirements in place.⁶⁰ For example, in the UK, registration and authorisation requirements were insufficient to prevent NCIs pursuing higher-risk consumer segments, offering high risk loans to borrowers with very limited and vulnerable means.

3.4. Consequences of irresponsible lending and borrowing

The problems identified result in significant consequences for consumers, credit intermediaries, creditors and the economy at large.

3.4.1. Significant spill-over effects on the wider economy

Mortgage credit markets play an important role in the EU economy. In 2008, outstanding residential mortgage lending in the EU27 represented about 50 % of EU GDP. The size and structure of mortgage credit markets as well as the distribution channels however vary widely.⁶¹ Given the size and importance of mortgage credit markets to financial institutions and borrowers alike, irresponsible lending and borrowing can have a significant effect on the wider economy.

Irresponsible lending and borrowing impacts on the solvability of mortgage lenders. Notably, some of the high profile collapses in recent years have been mortgage lenders (e.g. Northern Rock, Bradford and Bingley, and DSB Bank). This contributes to the general climate of economic and financial uncertainty. Financial institutions need to put aside increasing amounts to capital to cover bad losses, reducing the availability of credit for responsible borrowers and companies, which in turn places limits on economic growth and consumption. Furthermore, irresponsible lending and borrowing, combined with the other factors mentioned in Section 3.2, has had a concrete financial impact through government bail-out programmes or nationalisation.⁶² In the UK as illustrated below, 20 % of GDP has been given directly to the financial and other sectors to cover bad debts and ensure sufficient capital. As a consequence, government budgets are put under strain and budget cuts are often necessary. In Latvia, for example, austerity measures including a 30 % cut in public sector employees and 30 % cuts in public sector pay have been introduced to help the country, and in particular the financial sector resolve the bad debts. In parallel, social safety nets are put under strain with rising unemployment and increased demand for social expenditures and housing.

⁵⁹ See Annex 4, Section 6.2.

⁶⁰ The market share of NCIs in the UK increased from 4 % in 2000 to 15 % in 2008. In 2009, many NCIs pulled out of the UK market. Source: *DP09/3 Mortgage Market Review*, Financial Service Authority, October 2009, p. 34.

⁶¹ *Hypostat 2008: A review of Europe's Mortgage and Housing Markets*, European Mortgage Federation, November 2009, pp. 7, 70 and 71.

⁶² See Annex 4, Section 4.9.1, Table 27.

Irresponsible lending and borrowing can also have broader economic and social consequences in the form of overindebtedness. Overindebtedness is when citizens have difficulties meeting (or are falling behind with) their household commitments, whether these relate to servicing secured or unsecured borrowing or to payment of rent, utility or other household bills.⁶³ At a personal level, overindebtedness can lead to health problems and reduced access to financial services, including affordable credit. In macroeconomic terms, overindebtedness can also represent a cost for society in terms of reduced productivity, health related costs and welfare expenditure.⁶⁴

Finally, as illustrated by the financial turmoil, irresponsible lending and borrowing can have effects far beyond the jurisdiction where the lending took place. The existence of international banks who have branches, subsidiaries, or own banks across the globe; international securities markets which buy and sell mortgage backed securities and bonds in the global marketplace; and borrowers who seek to maximise their purchasing power to achieve their aspirations, have all contributed to transmitting the impact of irresponsible lending and borrowing. Such transmission mechanisms are even stronger in today's integrated EU marketplace. For example, the Swedish ownership of Latvian banks has contributed to spread into the Swedish market the consequences of the irresponsible lending practices of Latvian banks to Latvian consumers.⁶⁵

3.4.2. Risk of consumer detriment

These problems lead to consumer detriment in a variety of forms, affecting not only individuals but society as a whole. Market failures can lead the consumer to not purchase the best product for his/her needs. Consumers who are sold unsuitable products often run into financial difficulties, leading to overindebtedness, as well as default or even foreclosure of the property.⁶⁶ Consumers may be damaged by regulatory barriers that prevent creditors properly assessing a borrower's creditworthiness and suitability; inadequate suitability and creditworthiness checks; or the additional costs faced by creditors operating cross-border. Such consumers could face a direct financial detriment (e.g. by paying a higher price for a product that could be available for less) or even a potential social detriment (e.g. not obtaining a mortgage credit despite being able to repay because the creditor doesn't have enough information on him/her). Finally, consumers may lose confidence in creditors and credit intermediaries. For example, in the UK, 35 % of consumers do not believe that banks treat them fairly and 32 % felt that they do not trust their bank to sell them products that suit their needs.⁶⁷ Similarly, in Belgium, one out of every three customers does not trust banks and less than 50 % of the customers felt that their bank is acting in the interest of its customers.⁶⁸ This loss of confidence can arise in a variety of ways ranging from irresponsible lending activities to the existence of gaps in the regulatory coverage.

⁶³ *Towards a Common Operational European Definition of Over-indebtedness*, Observatoire de l'épargne Européenne in cooperation with CEPS and the University of Bristol, February 2008.

⁶⁴ *Tackling Overindebtedness, Annual Report 2007*, <http://www.bis.gov.uk/files/file42700.pdf>.

⁶⁵ Although Swedish ownership of Latvian banks meant that the cross-border transmission mechanism was stronger, irresponsible lending practices, e.g. foreign currency lending, did have a role to play. See *Latvia threatens foreign banks with huge losses*, The Guardian, 7.10.2009; *Latvian lessons to be heeded*, ThePost.ie, 16.5.2010.

⁶⁶ See Annex 4, Section 4.

⁶⁷ *Making Lending Responsible, Which?*, August 2007.

⁶⁸ *Winning back your Customers, Retail banking study*, Deloitte, 2010.

3.4.3. Low cross-border activity

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 advertising and marketing material, information disclosures, products, business models and pricing strategies⁶⁹ raise the costs of doing business in another Member State⁷⁰. Although certain one-off costs can be expected by creditors and credit intermediaries seeking to operate cross-border, many of the economic barriers present higher ongoing costs for creditors and may lead to unexploited economies of scale. As such, these barriers deter market entrants and limit competition⁷¹. Credit intermediaries seeking to operate cross-border face an additional burden: there is no 'passporting' regime, consequently, additional requirements need to be met in each Member State, adding additional costs.

Legal barriers may prevent or complicate the offering of certain products or the accessibility to market infrastructures⁷², thus limiting competition, stifling innovation, and preventing the creation of a single market in mortgage credit. 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 creditors and credit intermediaries from entering into cross-border activity⁷³.

3.4.4. Unlevel playing field between market actors and products

The regulatory gaps and inconsistencies have created a situation where credit intermediaries and creditors engage in the same activities and face similar risks but not necessarily similar rules. For instance, some NCIs are not subject to regulatory and supervisory requirements, whereas credit institutions are. Similarly, credit intermediaries typically face less stringent conduct of business rules. This creates the risk of regulatory arbitrage. Different rules increase market fragmentation, rendering cross-border activity more difficult to some actors. The regulatory gaps can also pose in theory significant risks to systemic financial stability as the recent sub-prime crisis illustrated: in the US where mortgage brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 % of subprime mortgages⁷⁴. Although such widespread regulatory failure is not evident in the EU, similar regulatory and supervisory gaps, and thus the potential for corresponding risks of such practices exists in the EU⁷⁵.

The different regulatory frameworks on consumer credit and mortgage credit can also lead to arbitrage between the two different loan products (consumer credit and mortgage credit). In

⁶⁹ The ability to perform creditworthiness checks is a pre-condition for lenders to take responsible lending decisions, especially in a cross-border context. See *Summary of Responses to the public consultation on responsible lending and borrowing in the EU*, 30.11.2010, pp. 9–11.

⁷⁰ E.g. Annex 4, Sections 2 (pre-contractual information) and 4 (creditworthiness and suitability).

⁷¹ *Report on the retail banking sector inquiry*, SEC(2007) 106, European Commission, 31.1.2007, p. 32.

⁷² See Annex 4, Section 4.

⁷³ See Annex 4, Section 2.

⁷⁴ See footnote 51.

⁷⁵ Some Member States, such as Spain, have introduced a more stringent regulatory and supervisory regime: <http://www.bde.es/clientebanca/entidades/otros/intermediarios.htm>. Others, such as the UK, have indicated that there are considerable risks and gaps in the mortgage intermediary sector: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2008/1112_It.shtml.

certain cases, e.g. when a consumer is seeking a loan to renovate their property, creditors have to decide whether to offer a secured credit (mortgage credit) or an unsecured credit (consumer credit); a consumer will therefore have a choice between a mortgage credit or a consumer credit. While consumer credit operates under an EU-wide framework⁷⁶ which, amongst other things harmonises the APRC, there is no comparable framework for mortgage credit. Consequently, the consumer may be misled into thinking they are provided with comparable APRC when in reality they are not.

3.4.5. *Low customer mobility*

Customer mobility and the propensity of consumers to switch providers can influence the level of competition. Several of the problems identified above impede customer mobility. First, a key factor in promoting customer mobility is price transparency. A lack of transparency can lead to consumers failing to shop around. Surveys show that consumers view the comparability of the different offers as the second most important factor impacting on their decision whether to switch mortgage credit provider.⁷⁷ Second, for consumers, barriers that prevent creditors from undertaking adequate creditworthiness or suitability checks can also harm their ability to get a loan and/or the price at which it is offered can also impact on consumer mobility. Consumers seeking to take out a loan cross-border may face higher prices or be denied the opportunity due to the fact that the foreign creditors are unable to access sufficient information on the consumer's credit history.

3.5. **Conclusion**

It is difficult to rank the different problem areas. These problems cannot be quantified to a large extent. However, in order to provide a rough indication of the size of the problem, the annual value of EU mortgage defaults may be used as a proxy. Using this approach, the problem is worth EUR 17.8 billion per annum. On the basis of the evidence we have, we believe that the most negative consequences stem from the problems identified with regard to pre-contractual information, creditworthiness and suitability assessments and credit intermediaries. The expected default rate reductions listed in Table 2 provide an order of magnitude of the problems each policy option aims to overcome.

In almost all instances, credit intermediaries and creditors compete in an unlevel playing field, opportunities are missed by consumers, creditors and credit intermediaries, and consumers face a risk of detriment. At a macroeconomic level, as described above, the EU is characterised by a fragmented single market for mortgage credit, with a risk of consumer detriment and financial instability.

⁷⁶ See footnote 25.

⁷⁷ *Consumers' views on switching service providers*, Flash Eurobarometer 243, January 2009, p. 52.

4. POLICY OBJECTIVES

In general terms, what is sought is to ensure responsible access to and provision of mortgage credit. In this context, there are two general objectives. These are common to all problem areas.

- To create an efficient and competitive Single Market for consumers, creditors and credit intermediaries with a high level of consumer protection by fostering:
 - consumer confidence;
 - customer mobility;
 - cross-border activity of creditors and credit intermediaries;
 - a level playing field.
- Promote financial stability by ensuring that mortgage credit markets operate in a responsible manner.

The specific and operational objectives of individual measures are described in detail in Annex 4. Table 1 summarises the specific problems, their drivers, and their corresponding objectives. Specific problems and the related specific objectives are shown in bold. Drivers and operational objectives are shown as bullet points.

The problems and corresponding objectives for early repayment are set out in the impact assessment accompanying the White Paper on the Integration of EU mortgage credit markets.⁷⁸

⁷⁸ SEC(2007) 1683, Annex III, p. 55-80, and in particular, p. 64, and SEC(2007) 1685.

Table 1: Problems and objectives

Specific problems	Specific and operational objectives
<p>Non-comparable, unbalanced, incomplete and unclear advertising</p> <ul style="list-style-type: none"> • Risk that advertising materials mislead consumers • Lack of EU wide comparability of advertising materials • Inconsistencies and gaps in the rules covering the advertising of mortgage credit 	<p>Ensure that mortgage advertisements are balanced, complete, clear and allow comparability of products</p> <ul style="list-style-type: none"> • Ensure that mortgage advertisements contain clear, complete and balanced information • Ensure that mortgage advertisements are presented in a way that enables objective comparison of different offers • Ensure that customers shopping cross-border and operators wishing to offer their services cross-border are not being burdened by inconsistent regulation
<p>Insufficient, untimely, complex, non-comparable and unclear pre-contractual information</p> <ul style="list-style-type: none"> • Pre-contractual information does not allow consumers to take informed decisions and/or to compare offers • Lack of monitoring and enforcement mechanisms • Inconsistency between provision of information by creditors and provision of information by credit intermediaries • Untimely receipt of pre-contractual information 	<p>Provide consumers with the means to make informed decisions in sufficient time to enable them to shop around</p> <ul style="list-style-type: none"> • Ensure that the information provided is comparable, both nationally and across the EU • Ensure that the information provided is complete, clear and in manner that is easy for consumers to understand • Ensure that the framework on information is properly monitored and enforced • Ensure that all creditors and credit intermediaries provide adequate information • Ensure that the information is provided in sufficient time for the consumer to shop around • Ensure that originators and distributors operating cross-border do not need to comply with heterogeneous sets of information requirements
<p>Provision of inappropriate advice</p> <ul style="list-style-type: none"> • Conflicts of interest, arising, e.g. from remuneration systems, can influence the quality of advice • Lack of clarity on liability for unsuitable advice • Absence of regulatory standards to ensure a high quality of advice 	<p>Ensure that mortgage advice provided is objective, impartial, and in the consumer's best interest</p> <ul style="list-style-type: none"> • Minimise the risk that conflicts of interest (e.g. remuneration) influences the quality of advice • Improve the degree of legal certainty with respect to the provision of advice and ensure that advisers meet minimum standards • Ensure that customers shopping cross-border and operators wishing to offer their services cross-border are not being burdened by different advising rules
<p>Inadequate suitability and creditworthiness assessment</p> <ul style="list-style-type: none"> • Incentives not right to conduct appropriate creditworthiness and/or suitability assessment • Inability to access reliable appropriate information on the borrower • Inexistent EU regulatory framework to conduct a careful assessment of suitability and creditworthiness • Barriers to accessing reliable appropriate information on the borrower 	<p>Ensure that creditors and borrowers take appropriate lending and borrowing decisions</p> <ul style="list-style-type: none"> • Ensure that conflicts of interest do not influence lending and borrowing decisions • Ensure access to appropriate information to assess creditworthiness and suitability • Ensure that creditors adequately assess consumers' creditworthiness • Ensure that creditors and/or credit intermediaries adequately assess the suitability of the credit to consumers' needs and preferences
<p>Ineffective, inconsistent, or non-existent registration, authorisation and supervision regimes for credit intermediaries</p> <ul style="list-style-type: none"> • Registration and authorisation gaps • Prudential and supervisory gaps 	<p>Ensure appropriate regulatory regime for credit intermediaries to integrate the Single Market</p> <ul style="list-style-type: none"> • Ensure that all credit intermediaries are appropriately registered, authorised, and supervised • Ensure that there is a level playing field between credit intermediaries, and credit intermediaries and other market players
<p>Ineffective, inconsistent, or non-existent registration, authorisation and supervision regimes for NCIs</p> <ul style="list-style-type: none"> • Registration and authorisation gaps • Prudential and supervisory gaps 	<p>Ensure appropriate regime for uptake, pursuit and supervision of NCIs</p> <ul style="list-style-type: none"> • Ensure that all NCIs are appropriately registered, authorised, and supervised • Ensure that there is a level playing field between NCIs and other market players

5. THE CASE FOR ACTION AT THE EU LEVEL

According to the subsidiarity principle, Community action should only be taken if the envisaged aims cannot be achieved by Member States alone. Admittedly, EU intervention cannot easily address some of the more intangible features of cross-border take-up of mortgage credit, such as language or distance. Nevertheless, EU intervention can be justified to achieve the outlined objectives for several reasons.

First, factors that prevent the pursuit of business or raise the cost of doing business in another Member State relative to the costs faced by domestic providers can be addressed by appropriate EU policy initiatives. Some of the problems identified could raise the cost of mortgage lending for domestic providers or prevent them from doing business. However, the costs of entering into business are exacerbated for creditors seeking to engage in cross-border activity and can deter new market entrants thereby restricting competition. A harmonised set of rules, including for consumer protection, would reduce creditors' and intermediaries' sunk costs, thus facilitating cross-border business. Research appears to indicate that despite the financial crisis, potential exists for developing a single market in mortgage credit; a recent survey of creditors indicates that they expect cross-border activity in the field of mortgage credit to increase in the next five years. It is expected that this growth will be driven by the lower cost of doing business via platforms such as credit intermediaries.⁷⁹

Second, the problems identified lead to consumer detriment through low consumer confidence, higher costs and reduced customer mobility, both domestically and cross-border, and thus represent a cost for society as a whole. In a competitive and efficiently functioning single market with a high level of consumer protection, consumers would search for the best product offered for their needs, be it in their own country or in another Member State. EU consumers continue to predominantly shop locally though for their mortgage credits: the number of consumers purchasing cross-border financial services either locally via a foreign provider or in another Member State via a range of distribution channels (e.g. intermediary, branch, subsidiary) is limited.⁸⁰ This can be attributed, inter alia, to two 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-border⁸¹). Many consumers also 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 as factors preventing them operating cross-border.⁸² Ensuring that the single market operates with a high level of consumer protection by addressing those issues that matter to consumers, such as pre-contractual information should stimulate consumer confidence and thus their demand for foreign credit products.

At the macro level, financial stability is a central aim of the recent measures to enhance supervision across the EU. In this context, financial integration and stability are mutually

⁷⁹ See footnote 57, pp. 129 and 262.

⁸⁰ *Public Opinion in Europe on Financial Services*, Special Eurobarometer 230, August 2005, p. 39.

⁸¹ See footnote 80.

⁸² See footnote 80.

reinforcing objectives which operate at the national level but crucially depend on certain tasks which can only be achieved at the EU level. As the recent financial crisis illustrated, the effects of irresponsible lending in one country can quickly spread beyond national borders due in part to the multinational presence of certain banking groups and also the international nature of securitised risk. As described in Section 3.2.4, there are parallel initiatives at the EU level to address other potential channels of cross-border spill-over: supervision of cross-border banks, increased capital requirements, holding requirements for 'creating and trading' of securitised products. But these act at a different level: respectively between banks and supervisors, 'inside banks', or amongst financial institutions (originate and distribute model). This impact assessment focuses on the interaction between creditors/intermediaries and citizens. Irresponsible lending and borrowing was one of the factors at the origin of the financial crisis: it greatly contributed to the emergence of the financial turmoil. The creation of standards at an appropriate level would ensure that mortgage credit origination in the EU is undertaken in a responsible manner and contribute to promoting EU financial, economic and social stability.

Against this background, and as described in Section 3.2.3, action from Member States alone is likely to result in different sets of rules, which may undermine or create new obstacles to the functioning of the internal market and create unequal levels of consumer protection in the EU. Common standards at EU level are therefore necessary to promote an efficient and competitive internal market with a high level of consumer protection. Such standards are further essential in order to ensure that the appropriate lessons are learnt from the sub-prime crisis and to ensure that such a financial crisis does not reoccur in the future. Although it may be argued that any irresponsible lending has ceased in recent years as the availability of credit has fallen, such an approach is short-termist and does not anticipate the fact that lending, house prices, and mortgage markets will recover to the pre-crisis at some point.

The Treaty provides for action to ensure the establishment and functioning of an internal market with a high level of consumer protection as well as the free provision of services. Such a market for residential mortgages is far from completion as several obstacles exist to the free provision of services and the creation of an internal market. These obstacles restrict the level of cross-border activity on the supply and demand sides, reducing competition. Creditors may be less efficient than they could be and borrowers may face the risk of consumer detriment. The legal basis for action is in the following Treaty provision:

- Article 114 (ex-Article 95) allows for the adoption of "measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market". In doing this, according to the Treaty, the Commission will take as a basis a high level of consumer protection.

In conclusion, EU intervention complies with the subsidiarity principle.

6. POLICY OPTIONS, IMPACT ANALYSIS AND COMPARISON

This section summarises the policy options and their impacts on stakeholders. Due to the number of the areas covered, the analysis of policy options and the comparison thereof have been combined for each area. Where necessary, sub-issues have been addressed by separate policy options. The policy options are not necessarily mutually exclusive and should not therefore automatically be viewed as alternatives. They may be combined to achieve a more effective and efficient outcome. The preferred policy options are indicated in bold. When comparing the options, the tables illustrate how each of the policy options contributes to meeting the objectives and their efficiency (cost-effectiveness) in doing so when compared to the 'Do nothing' hypothesis. The following schema is used ✓✓✓ (strong positive contribution), ✓✓ (moderate positive contribution), ✓ (weak positive contribution), ✕✕✕ (strong negative contribution), ✕✕ (moderate negative contribution), ✕ (weak negative contribution) and 0 (neutral contribution). The impact on stakeholders follows a similar approach.

6.1. Methodology

The assessment of the options is based on both quantified and non-quantified costs and benefits. Quantified costs, accrued to creditors, credit intermediaries and Member States are divided into one-off costs and annual recurring costs unless otherwise indicated. Costs for consumers and society are in the form of a potential reduction in access to credit are not quantified. The benefits quantified, accrued to consumers and society as a whole, come through a reduction in defaults and are provided on an annual basis. Other expected benefits to consumers, Member States, creditors and credit intermediaries are not quantified. Annual recurring costs and benefits have not been discounted. A detailed description of the quantitative analysis of the options for each subtopic is in Annex 4. Further information on the methodology is in Annex 5.

6.1.1. Costs

One-off costs to creditors and credit intermediaries include estimations of the costs for staff training and investment in IT and systems modifications as well as adaptations of standard operating procedures, etc. Costs for training are based on the assumption of either 2 man hours training for certain topics (advertising and marketing; information, advice) and 8 man hours training for more complex topics (creditworthiness/suitability and advice). The costs are estimated using Eurostat data for the average hourly wage in the financial sector. Most policy options will also require IT and systems adjustments as well as changes to the standard operating procedures, etc. In this case, a certain number of man days are assumed. The cost per institution is calculated using the number of man days and the hourly wage. In some instances, additional one-off costs are calculated. Recurring costs to creditors and credit intermediaries include estimations of compliance costs as well as the cost of possible additional time required to undertake certain actions, e.g. collect information on the borrower. The main cost for creditors and intermediaries is the cost of checking compliance with new regulation. In general, it is assumed that 10 % of mortgage credit transactions will be checked for compliance and that this check will take approximately half an hour.

Costs to Member States also reflect one-off costs (costs of developing and introducing new rules) and recurring costs (costs of supervising and enforcing the rules). Recurring costs are estimated at X number of hours (estimates are provided for 1, 2 and 3 hours) times average

hourly wage (EUR 31.56) times the total number of market participants (the number varies depending on whether the policy option is applied to creditors, credit intermediaries, NCIs, etc.). In certain instances, e.g. for credit intermediaries and NCIs, Member States may however face additional costs such as the cost of establishing a register. In several instances, Member States already apply or intend to apply the proposed rules. It is assumed that under such circumstances, these Member States will not incur incremental costs.

Consumers and society will also face a cost in the form of reduced access to credit. While the mainstream access to credit should be positively influenced by these proposals, certain vulnerable groups may face a reduced access to credit as a result of some of these proposals. The size of this reduced access to credit is not quantifiable on an EU-wide basis due to a severe lack of data as well as the fact that it is difficult to attribute more restricted access to mortgage credit to the proposed policy options alone. Access to mortgage credit depends on other factors such as the availability of finance to the creditor or housing market developments. Moreover, the cost of reduced access to credit for (certain categories of) consumers will be counterbalanced by the fact that those borrowers who do have access to credit should face lower costs as the 'good' borrowers will no longer be paying a higher interest rate to cover the costs of 'bad borrowers' defaulting. In addition, consumers who would be denied credit may – in the long run – end up being better off as a result of the denial of credit as they would have avoided the broader negative consequences of overindebtedness and the negative social and economic effect of losing their home. Consequently, reduced access can be both due to less irresponsible lending or reduced lending to certain groups regardless of their individual creditworthiness. In the latter case, it can be considered as a cost but in the former it would not since it would be one of the reasons why defaults decrease.

6.1.2. Benefits

The benefits to consumers and society as a whole come through a reduction in defaults. The policy options lead to a situation where the product purchased by the consumer is better suited to his/her needs as well as his/her financial and personal circumstances. This means that the risk of overindebtedness will decrease and hence the level of defaults will fall.

For the purpose of this impact assessment, defaults will be assumed to have an impact on consumers. The estimated impact of policy options on the level of defaults is presented in Table 2. The impact of the 'Do nothing' option are not included because in all cases, the assumption is that the reduction in the default rate will be zero. The estimations have been made by Commission services on the basis of a rigorous analysis of stakeholders' contributions and the evidence collected. Since the positive effect on default rates is expected to continue over the years for all policy options, the calculated benefits are to be considered as annual benefits and are not discounted. It should be noted however that the figures presented in the impact assessment offer only a rough estimation of the expected benefits for several reasons.

First, the impact is on society at large as defaults also lead to costs for creditors as well as consumers. However, allocating the costs of defaults between consumers and other stakeholders is not feasible, thus it is assumed that all the costs of default will be allocated to consumers and society at large. Second, the benefits may be underestimated because no consideration has been given to the other economic and social costs linked to the default and that will be avoided. These additional costs include for instance the legal costs linked to the often lengthy foreclosure procedure and the social cost for the borrower of losing his home. There is also the uncertainty for the creditor as to whether the lent amounts will be recovered

(particularly in the event of declining houses prices) and for the borrower as to whether he will be able to find another home. Third, the estimated value of the defaults also risks overestimating the benefits. Indeed, foreclosed properties will most often be sold and their sale value would then partially compensate for the credit loss. Finally, consumers will also face benefits through the increased understanding and comparability of offers. As a result, consumers will increasingly compare offers and shop around for better products and deals. This should increase competition between creditors and reduce the costs/prices paid by the consumer. Such benefits are not quantifiable due to the lack of data on consumer behaviour, price elasticities, etc. Given these different effects, in particular the potential size of non-quantifiable benefits, it is argued that the overall estimations of the impact of a reduction of defaults are conservative estimates.

Table 2: Impact of policies on default rate – Overview of assumptions

Basis point fall	Policy option
Small: 0-0.5	Credit intermediaries (Option 1.4, Option 2.4); NCLs (Option 1.4, Option 2.4)
Small: 0.5-1.5	Credit intermediaries (Option 2.3); NCLs (Option 2.3)
Small: 0.5-1	Advertising and marketing (Option 2); Pre-contractual information (Option 3.1); Credit intermediaries (Option 1.2, Option 2.2); NCLs (Option 2.2)
Small: 1-1.5	Advertising and marketing (Option 3)
Small: 0.5-1.5	Pre-contractual information (Option 5.1)
Small: 1.0-2.0	Pre-contractual information (Option 5.2); Pre-contractual information (Option 6); Suitability assessment (Option 2.4); Credit intermediaries (Option 1.3); NCLs (Option 1.2)
Small: 1.5-2.5	Pre-contractual information (Option 3.2); Pre-contractual information (Option 5.3); NCLs (Option 1.3)
Medium: 2.5-5	Pre-contractual information (Option 2)
Medium: 2.5-3.5	Pre-contractual information (Option 4); Advice and explanations (Option 1.2); Creditworthiness assessment (Option 1.5)
Medium: 3-4	Advice and explanations (Option 1.3)
Medium: 3-5	Creditworthiness assessment (Option 1.4)
Medium: 4-5	Advice and explanations (Option 1.4)
Medium to high: 4-6	Advice and explanations (Option 2.2 and Option 2.3)
High: 6-8	Suitability assessment (Option 2.5)
High: 7-9	Suitability assessment (Option 2.2)
High: 8-10. But includes the previous option benefits.	Suitability assessment (Option 2.3 but includes Option 2.2)
High (upper range). 10-15	Creditworthiness assessment (Option 1.2)
High (upper range). 15-20. But includes Option 1.2	Creditworthiness assessment (Option 1.3 but includes Option 1.2)

The main benefits for creditors and credit intermediaries will be in the form of greater business opportunities. These would stem from lower costs of operating cross-border and higher consumer confidence and therefore demand. This should increase competition between creditors and put down the costs/prices paid by the consumer. Similar impacts could be expected from policy options that encourage creditor and credit intermediaries' cross-border activity. Quantification of these benefits has not been possible due to the lack of relevant data. Likewise, diminished difficulties in payments (and recurrent arrears) are another set of benefits that are difficult to quantify. Benefits in terms of reduced risk of defaults, as explained above, have been attributed to consumers and society. Finally, market actors should also benefit from enhanced financial market stability.

Member States would however also face lower costs and thus benefits because reduced defaults and foreclosures would mean lower costs in terms of providing social housing, etc. for those consumers who lose their homes. These costs are not however quantifiable and would vary considerably between Member States depending on their housing policy.

6.2. Advertising and marketing

6.2.1. Available options

Table 3 gives an overview of the policy options: a detailed description and an assessment of their effectiveness and efficiency are in Annex 4, Section 1.

Table 3: Advertising and marketing – Policy options

Policy option
1: Do nothing
2: Application of Article 4 of the CCD
3: Specific rules on the format and content

6.2.2. Comparison of options

The set objectives cannot be achieved under the 'Do nothing' scenario. Option 1 is not effective as it preserves the status quo and thus all the problems identified in Section 4.2.1. Options 2 (introduction of rules similar to the CCD) and 3 (introduction of mortgage specific rules) are considered to be equally effective in terms of promoting a level-playing field and promoting cross-border mobility; both options introduce EU-wide rules that facilitate cross-border business for creditors and credit intermediaries, as well as provide consumers with the same high level of protection thus enhancing consumer confidence. However, under Option 3, the rules would be able to take into account the specificities of mortgage credit (duration of credit, home used as collateral, etc.), thus further enhancing consumer understanding and confidence and reducing consumer detriment. Option 3 is therefore most effective in reducing the risk of mortgage advertising that could mislead and/or cause consumer detriment, particularly for those consumers with low levels of financial literacy and other vulnerable groups. It is thus, by implication, also the most effective in reducing risks to the overall financial and social stability of the Member States. As such, while Option 2 is effective in meeting the objectives, Option 3 is more effective in ensuring comparable, balanced, complete and clear advertising and marketing materials. Finally, both options were found to be equally efficient in achieving the pursued objectives. In conclusion, Option 3 was found to be the best choice for achieving the objectives, taking into account its effectiveness and efficiency.

Table 4: Advertising and marketing – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving all objectives
	General objectives						
	Specific objectives	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
	Ensure that mortgage advertisements are balanced, complete, clear and allow comparability of products	Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1: Do nothing	0	0	0	0	0	0	0
2: Application of Article 4 of the CCD	✓	✓	✓	✓	✓	✓	✓
3: Specific rules on the format and content	✓✓	✓✓	✓	✓	✓	✓✓	✓✓

6.2.3. Impact of the preferred option on stakeholders

Option 3 (specific rules on the format and content of mortgage advertising and marketing) entail mainly costs for creditors and credit intermediaries, although Member State administrations would also face some limited costs. Society as a whole and consumers in particular would face benefits⁸³.

With respect to creditors and credit intermediaries, the costs relate to one-off costs in all 27 Member States. These are estimated at EUR 51 million, reflecting the costs of staff training as well as the costs of adapting systems and materials. No incremental recurring costs are foreseen for creditors and credit intermediaries due to the fact that compliance with existing marketing and advertising rules already needs to be ensured. Some benefits in terms of economies of scale and scope and potentially increased opportunities to attract customers are envisaged, however these benefits are not quantifiable for the reasons explained previously. It is however unlikely that these benefits outweigh the costs to creditors and credit intermediaries.

Table 5: Advertising and marketing – Impact on main stakeholders

	Consumers and society	Creditors and credit intermediaries	Member States
1: Do nothing	0	0	0
2: Application of Article 4 of the CCD	✓	✗	✗
3: Specific rules on the format and content	✓✓	✗	✗

The one-off costs for Member States for introducing the rules under this option is estimated to be EUR 0.6 million as 27 Member States would have to introduce new rules on advertising and marketing. As for creditors and credit intermediaries, incremental recurring costs are not envisaged as monitoring and enforcement of advertising and marketing rules already occurs.

There should be substantial benefits for consumers from the greater clarity, balance, completeness and comparability of mortgage advertising. This should reduce the risk of

⁸³ For more details on how the costs and benefits have been calculated see Annex 4, Section 1.

consumers, particularly consumers with low incomes or low levels of financial literacy, being misled, facilitate consumer understanding and the ability to compare products. This is expected to result in the purchase of fewer unsuitable products, reducing the average mortgage default rate across the EU. The overall benefits are estimated at EUR 124-187 million. This is a benefit not only for consumers, but for society as a whole; the expected reduction in consumer detriment and mortgage defaults due to the purchase of suitable products constitutes a positive impact on the overall social and financial stability of Member States. These positive benefits for society are assumed to outweigh the costs.

6.3. Pre-contractual information

6.3.1. Available options

Table 6 gives an overview of the policy options: a detailed description and an assessment of their effectiveness and efficiency are in Annex 4, Section 2.

Table 6: Pre-contractual information – Policy options

Policy option
1: Do nothing
2: Ensure that consumers receive the ESIS
3: Ensure that the ESIS is provided in sufficient time to enable consumers to shop around
<i>3.1: Principles-based requirement</i>
3.2: Specify a deadline for the provision of information
4: Improve the format and content of the ESIS
5: Standardise the Annual Percentage Rate of Charge (APRC)
<i>5.1: Standardise on the basis of a narrow definition</i>
5.2: Standardise on the basis of Article 19 of the CCD
<i>5.3: Standardise on the basis of a broad definition</i>
6: Additional pre-contractual information

6.3.2. Comparison of options

Clear, understandable and comparable information is an essential element in responsible lending and borrowing. 'Doing nothing' (Option 1) would neither address any of the problems identified nor achieve any of the objectives. Option 1 is therefore discarded.

While Table 7 assesses the effectiveness and efficiency of the individual policy options, it is important to underline that the different policy options are not necessarily mutually exclusive and may be combined to have a more effective and efficient set of measures which fully address problems outlined and objectives set.

Table 7: Pre-contractual information – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Provide consumers with the means to make informed decisions in sufficient time to enable them to shop around	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
Improved consumer confidence		Customer mobility	Cross-border activity	A level playing field			
1: Do nothing	0	0	0	0	0	0	0
2: Ensure that consumers receive the ESIS	✓	✓	✓	✓	✓✓	0/✓	✓
3: Ensure that the ESIS is provided in time to enable consumers to shop around							
3.1: <i>Principles-based requirement</i>	0/✓	✓	✓	0/×	0	0/✓	0/✓
3.2: Specify a deadline for the provision of information	✓	✓	✓✓	0	✓	0/✓	✓
4: Improve the format and content of the ESIS	✓✓✓	✓✓✓	✓✓	0	0	✓✓	✓✓
5: Standardise the APRC							
5.1: <i>Harmonisation on the basis of a narrow definition</i>	✓	✓	✓	✓✓	✓✓	✓	✓
5.2: Standardise on the basis Article 19 of the CCD	✓✓	✓✓	✓✓	✓✓✓	✓✓	✓	✓✓✓
5.3: <i>Standardise on the basis of a broad definition</i>	✓✓✓	✓✓✓	✓✓✓	✓✓	✓	✓	✓✓
6: Additional pre-contractual information	✓✓	0	✓	✓✓	0	0	✓✓

A key element in ensuring that consumers receive appropriate information is the comprehensive provision of the ESIS. This can be done by ensuring that all interlocutors, be they creditors or credit intermediaries, provide the ESIS. While simply implementing Option 2 (obligation for all actors to provide the ESIS) would not solve all the problems relating to the content and/or format or general comprehensibility of the information provided, it would ensure that consumers actually receive the information. However Option 2 would be more effective if combined with an obligation to provide the ESIS at a certain moment (i.e. Options 3.1 and 3.2). While Option 3.1 (principles-based timing rules) would be flexible enough to ensure that national specificities were taken into account, there would also be risks that it creates an uneven playing field between different actors and potentially leading to no effective change in the current situation. For consumers, uncertainty surrounding when they would actually receive the ESIS would also be detrimental to consumer confidence and

shopping around. Thus, Option 3.2 (i.e. Option 2 coupled with a specific deadline for providing the ESIS) appears to be more effective.

In terms of ensuring that the information provided is complete, clear and easy for consumers to understand, Option 4 (revising the content and format of the ESIS based on the results of consumer testing⁸⁴) has the greatest impact in terms of improving the quality of the information provided. This option would enable consumers to understand the features and risks connected with a certain mortgage product and to use this knowledge to compare products and make an informed choice. Option 6 (additional information on the credit intermediary) is also effective in providing important information on the credit provider which is not contained in the ESIS. Option 4, improving the format and content of the ESIS, can be combined with Option 6, to ensure that consumers get complete, clear and understandable information. Given financial literacy levels, providing consumers with additional information does not mean that this would help them to better choose among credit products, however improving the understandability of the language used in the ESIS, for example, by limiting the use of overly technical terms, combined with measures to boost financial literacy referred to in Section 3.2.4, which are outside the scope of this impact assessment, would improve the overall effectiveness of this policy option.

As regards barriers to cross-border mobility, consumers would need to add substantial ancillary costs to calculate a measure that is an appropriate price indicator. The costs of searching and analysing the additional information are likely to be high (estimates based on stakeholder input put these costs equivalent to additional 1 hour of time⁸⁵). Options 5.2 and 5.3, adopting a CCD-type or broad APRC respectively, have been found to be more effective in achieving the objectives. Option 5.2 has some advantages in terms of encouraging cross-border mobility and, although not a specific objective and of less importance due to the small size of the market, creating a level playing field with consumer credit. Option 5.2 is more effective in promoting cross-border mobility as it allows a better comparison of the APRC, due to the fact that it does not include notary fees which vary from Member State to Member State. While some additional search costs would remain, e.g. for notary costs and taxes, these costs would be substantially lower than under Option 5.1 (estimates based on stakeholder discussions put these costs at 50 % less than under Option 5.1⁸⁶) because less information would need to be collected by consumers. Option 5.3 has the advantage of substantially reducing consumer search costs and improving confidence, however has a risk of misleading consumers about the best offer since the costs included in the APRC would vary considerably both within a Member State and across the EU, and could lead to unfair competition between creditors and credit intermediaries at the cross-border level. In addition, the costs for creditors of Option 5.3 will be higher since they will have to apply different calculation criteria when providing the APRC of consumer credits and of mortgage credits that they offer. Consequently, Option 5.2 (CCD-type) is the preferred option for the APRC.

In conclusion, the preferred option is therefore a combination of Options 2, 3.2 (provision of the ESIS with specific deadline), 4 (improve the content and format of the ESIS),

⁸⁴ Study on consumer testing of possible new format and content for the European Standardised Information Sheet (ESIS) on home loans, http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm.

⁸⁵ See footnote 9, pp. 186-187.

⁸⁶ See footnote 9, pp. 186-187.

5.2 (standardisation of the APRC based on the CCD definition) and 6 (provision of additional information).

6.3.3. Impact of the preferred options on stakeholders

This combination will ensure the comprehensive provision of high quality information in a timely manner. It is expected that substantial benefits to consumers and society at large as a result of consumers purchasing the most appropriate product for their needs and being less likely to being overindebted and default⁸⁷. These benefits, which are estimated at ranging from EUR 124 million (Option 5.2) to EUR 436 million (Option 4) depending on the policy option, should be viewed as for society as a whole. Consumers would also benefit from the harmonisation on a CCD basis (Option 5.2). Consumers would save time as they do not need to collect additional costs, except for those costs that the creditor is not aware of and costs such as notary fees, and calculate the more cost-inclusive measure. Consumers would also benefit from the increased comparability of offers and lower search costs as the provision of a high quality ESIS with relevant information in good time will reduce the need to search for, review and compare information and literature of the different creditors. This will increase customer mobility and competition between creditors and credit intermediaries, leading to a more efficient and competitive market. These benefits are however not quantifiable and thus not included in the quantification of the benefits.

Table 8: Pre-contractual information – Impact on main stakeholders

Stakeholders/ Policy options on ESIS	Consumers and society	Creditor	Credit intermediaries	Member States
1: Do nothing	0	0	0	0
2: Ensure that consumers receive the ESIS	✓	✓	✓	*
3: Ensure that the ESIS is provided in sufficient time to enable consumers to shop around				
<i>3.1: Principles-based requirement</i>	✓	*	*	*
3.2: Specify a moment/deadline for the provision of information	✓✓	***	***	*
4: Improve the format and content of the ESIS	✓✓✓	**	0	*
5: Standardise the APRC				
<i>5.1: Standardise on the basis of a narrow definition</i>	*	✓	0	*
5.2: Standardise on the basis of Article 19 of the CCD	✓✓	**	0	*
<i>5.3: Standardise on the basis of a broad definition</i>	✓✓✓	***	0	*
6: Additional pre-contractual information	✓✓	*	**	*

Creditors and credit intermediaries will face substantial one-off and recurring costs for implementing the combination of policy options. However, in practice substantial synergies can be obtained in staff training, in modifying IT and other systems, as well as in compliance. Moreover, creditors and credit intermediaries already have systems in place to provide pre-contractual information so incremental costs are likely to be lower yet. As such, these figures should be viewed as a substantial overestimation. There will also be benefits to creditors and credit intermediaries in the form of increased opportunities for economies of scale and scope both domestically and cross-border.

⁸⁷ For more details on how the costs and benefits have been calculated see Annex 4, Section 2.

The costs to governments and regulators in the event of a legislative instrument are likely to be low to moderate and are unlikely to be much higher than EUR 0.6 million. This is because the costs of introducing or modifying rules, in the event of a legislative instrument, would not be cumulative as the costs of introducing one policy option would be similar to the costs of introducing a package of policy options. Member States would also face the costs of supervision and enforcement in the event of a regulatory instrument being chosen. Moreover, incremental costs would be lower in certain Member States. For example, 11 Member States⁸⁸ already have or will apply the calculation method in Article 19 and Annex 1 of the CCD⁸⁹ and a further 13 Member States⁹⁰ have or will apply the definition of the APRC in Article 3(g)-(i) of the CCD⁹¹ to mortgage credit.

In addition to estimations of costs and benefits by Commission services described above, an external cost-benefit analysis⁹² on the combined impact of Options 2, 3 and 4 has concluded that there could be substantial benefits if a user friendly ESIS is provided by all actors in a timely manner: EUR 219 million in the event of legally binding rules; but EUR 8.8 million in costs in the event of self-regulatory rules.

6.4. Advice

6.4.1. Available options

Two problem areas have been identified: rules and standards for mortgage advice; and remuneration strategies which have an influence on the quality of advice, each consisting of a number of policy options. Table 9 outlines the policy options. A detailed description of all the options and an assessment of their effectiveness and efficiency are in Annex 4, Section 3.

Table 9: Advice – Policy options

Policy option
Mortgage advice
1: Do nothing
1.2: Requirement to provide adequate explanations (Article 5(6) of CCD)
1.3: Principles-based advice standards
1.4: Requirement to provide mortgage advice
Remuneration strategies
2.1: Do nothing
2.2: Principles-based guidance on remuneration policies
2.3: Specific rules on methods and levels of remuneration

6.4.2. Comparison of options

The analysis of the policy options for mortgage advice and remuneration schemes demonstrates that the objectives of this initiative cannot be achieved under the 'Do nothing' scenarios. It has been shown that this option is not effective as it preserves the status quo and thus all the corresponding problems.

⁸⁸ Austria, Cyprus, Denmark, Estonia, Germany, Hungary, Malta, Romania, Slovenia, Spain and Sweden.

⁸⁹ See footnote 25.

⁹⁰ Austria, Cyprus, Denmark, Estonia, France, Germany, Hungary, Italy, Malta, Romania, Slovenia, Spain and Sweden.

⁹¹ See footnote 25.

⁹² See footnote 9, p. 157.

6.4.2.1. Mortgage advice

Although Option 1.4 (requirement to provide advice) was found to be effective in reducing the likelihood of consumer detriment and improving consumer confidence and mobility, it was less effective with respect to the other objectives, in particular it was deemed ineffective in ensuring the provision of high quality advice. Although Option 1.4 could be considered in conjunction with Options 1.2 and 1.3, the costs are significant for creditors and credit intermediaries. Negative impacts are also felt on the market for independent advice as well as consumers who do not want advice or who pay higher interest rates as a result of creditors and credit intermediaries passing through their costs.

Option 1.3 is the most effective in meeting the objectives. It has very beneficial impacts on consumers, while the impact on providers would be weakly negative. Option 1.3 could also be combined with Option 1.2 as the provision of explanations to all consumers (Option 1.2) together with the provision of advice according to certain standards to those consumers who want to receive it (Option 1.3) would be mutually reinforcing and ensure that all consumers who need a certain level of protection receive it and those who wish to receive advice can receive it in a high quality form. It follows that the two options taken together, lead to a regime where all consumers, whether in advised or non-advised sales are more likely to end up with suitable products, not suffer detriment, and grow in confidence.

Table 10: Mortgage advice – Comparison of options for effectiveness and efficiency

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure that any mortgage credit advice provided to a consumer is objective, impartial and in the consumers' best interest	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
1: Do nothing	0	0	0	0	0	0	0
1.2: Requirement to provide adequate explanations (Article 5(6) of CCD)	✓	✓✓	✓	✓/0	✓/0	✓	✓
1.3: Principles-based advice standards	✓✓✓	✓✓✓/✓✓	✓✓	✓/0	✓/0	✓	✓✓
1.4: Requirement to provide mortgage advice	✓	✓✓✓	✓/0	0	0	✓	*

6.4.2.2. Remuneration strategies

In general terms, both Options 2.2 and 2.3 (specific rules on which remuneration schemes are acceptable and which are not) are relatively effective in achieving the objectives, and reduce the risk that remuneration structures create misaligned incentives and lead to consumers, vulnerable groups such as those on low incomes and/or with low levels of financial literacy, are sold inappropriate products for their needs and circumstances. Option 2.3 may however have a slightly more positive impact on consumer confidence due to the greater legal certainty. Option 2.2 was also slightly less effective than Option 2.3 in tackling cross-border barriers to mobility and creating a level playing field. This is due to the fact that under

Option 2.2 uncertainty about whether particular remuneration structures would be allowed or not may create an unlevel playing field either between Member States or between creditors/credit intermediaries. At the same time, Option 2.2 is more flexible in accommodating national differences. Option 2.2 is also more efficient than Option 2.3. This was mainly due to the costs of Option 2.3 for creditors and credit intermediaries; this is because, apart from the quantified one-off costs that creditors and credit intermediaries would incur and which are described below, there are also significant intangible negative impacts relating to loss of flexibility, discretion, means of promotion, etc. Option 2.2 reduces the negative impact on providers, while still remaining effective in achieving the pursued objectives. It appears also to be in line with parallel proposed provisions in the framework of changes to the CRD.

Table 11: Remuneration strategies – Comparison of options for effectiveness and efficiency

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure that any mortgage credit advice provided to a consumer is objective, impartial and in the consumers' best interest	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
Improved consumer confidence		Customer mobility	Cross-border activity	A level playing field			
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Principles-based guidance on remuneration policies	✓✓	✓✓	✓	✓	✓	✓	✓✓
2.3: Specific rules on methods and levels of remuneration	✓✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓

6.4.3. Impact of the preferred options on stakeholders

6.4.3.1. Mortgage advice

Option 1.2 on adequate explanations was found to have a strong positive impact on consumers and society as a whole, mainly because of its contribution in the improvement of consumers' understanding, awareness, choice of suitable products, and a corresponding reduction in the likelihood of overindebtedness and mortgage defaults⁹³. This would lead to benefits of approximately EUR 40-56 million. Under Option 1.2 (and 1.3), consumers will also benefit slightly in terms of increased customer mobility. Similarly, there will be some modest benefits to creditors and credit intermediaries in the form of increased opportunities for economies of scale and scope both domestically and cross-border. Creditors and credit intermediaries will face costs, mainly caused by one-off and annual recurring costs that the introduction of rules would require. These are estimated at EUR 25 million and EUR 13-25 million respectively. According to estimates by Commission services, Member States would face one off costs of EUR 0.2 million and annual recurring costs EUR 0.2-0.5 million to develop and enforce the rules. External sources estimate the costs to

⁹³ For more details on how the costs and benefits in this section (mortgage advice) and the following one (remuneration schemes) have been calculated see Annex 4, Section 3.

Member States over 15 years (2009-2014) at EUR 10.5 million.⁹⁴ The large benefits to society however mean that there would be a net positive impact.

Table 12: Mortgage advice – Impact on main stakeholders

	Consumers and society	Creditors and credit intermediaries	Member States
1: Do nothing	0	0	0
1.2: Requirement to provide adequate explanations (Article 5(6) of CCD)	✓✓	*	*
1.3: Principles-based advice standards	✓✓	*	*
1.4: Requirement to provide mortgage advice	✓✓✓	xx	xx

Option 1.3 establishing principles for the provision of mortgage advice was found to have an even stronger positive impact on consumers and society as a whole (EUR 58-77 million), due to the provision of (more) objective, impartial, and suitable advice and thus reduce the risk of consumers ending up with unsuitable/unsustainable products and the associated risk of becoming overindebted, or even suffering defaults and foreclosures. Creditors and credit intermediaries would face one-off and annual recurring costs of EUR 30 million and EUR 15-30 million respectively. According to estimates by Commission services, Member States would face one off costs of EUR 0.1 million and annual recurring costs EUR 0.5 million to develop and enforce the rules. External sources estimate the costs to Member States over 15 years (2009-2014) at EUR 0.54 million.⁹⁵ The large benefits to society however mean that there would be a net positive impact.

6.4.3.2. Remuneration strategies

Option 2.2 establishing principles-based standards for remuneration was found to have a positive impact (EUR 349-523 million) on consumers and society as a whole, mainly because it aims to tackle remuneration schemes that can cause consumer detriment and potentially lead to overindebtedness and mortgage defaults. Benefits are incurred because borrowers are less likely to be sold a product which is in the interests of the provider rather than themselves, with the trickle-down effect of lower rates of default and foreclosure. The expected default rates reduction is important. This reflects the extent of a problem frequently invoked not only by consumers but also by representatives of financial services staff. These have repeatedly criticised the pressure staff receives to sell certain products irrespectively of those suiting the client or not.

Creditors and credit intermediaries would face EUR 3 million in costs, mainly caused by one-off costs. These one-off costs mainly relate to changes to the design and operation of remuneration schemes as it is assumed that no staff training is required. They would not face any incremental recurring costs. Creditors and credit intermediaries would also incur some intangible negative impacts relating to loss of flexibility, discretion, means of promotion, etc. Additionally, there is a small likelihood (which is the same under Option 2.2 and 2.3) that employees providing advice suffer a small revenue reduction because they can no longer increase revenue just by selling higher commission products. This cost is not quantifiable as it is uncertain. Employers may simply abolish commission based sales and compensate by raising employees base salary. In that case, no important negative impact on firms'

⁹⁴ See footnote 9, p. 471.

⁹⁵ See footnote 9, p. 471.

profitability should be expected since this policy will just imply a reallocation of expenses on staff. There are also more general impacts on creditors who will no longer be able to promote their own products when selling through intermediaries by offering higher levels of remuneration for specific products and will therefore be subject to more transparent competition. These costs are also not quantifiable. It should be noted that for credit institutions, changing the remuneration system will not necessarily increase the cost of remuneration (only the way the distribution is remunerated), so it would not affect remuneration levels directly. Member States will face EUR 0.6 million in one off costs for introducing and enforcing the rules. The large benefits to society however mean that there would be a net positive impact.

Table 13: Remuneration strategies – Impact on main stakeholders

	Consumers	Creditors and credit intermediaries	Member States
2.1: Do nothing	0	0	0
2.2: Principles-based guidance on remuneration policies	✓✓	*	*
2.3: Specific rules on methods and levels of remuneration	✓✓	xxx	*

6.5. Creditworthiness and suitability assessment

6.5.1. Available options

Two problem areas have been identified: creditworthiness assessments and suitability assessments, each consisting of a number of policy options. A detailed description of all the options and an assessment of their effectiveness and efficiency are in Annex 4, Section 4. Table 14 outlines the problem areas and the options contained in each. It is important to underline that the different policy options are not necessarily mutually exclusive and may be combined to have a more effective and efficient set of measures which fully address problems outlined and objectives set.

Table 14: Creditworthiness and suitability – Policy options

Policy option
Creditworthiness assessments
1.1: Do nothing
1.2: Requirement for the creditor to assess the borrower's creditworthiness
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment
1.4: Non-discriminatory access to databases for creditors
1.5: Homogenise the content and characteristics of databases
1.6: Requirement for the borrower to provide correct information on his/her situation
Suitability assessments
2.1: Do nothing
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her
2.4: Requirement for the borrower to provide correct information on his/her situation
2.5: Specific product regulation including bans or caps on certain credit products

6.5.2. Comparison of options

6.5.2.1. Creditworthiness assessments

Option 1 (Do nothing) is rejected since it would not address the problems identified and not achieve any of the envisaged objectives. Option 1.2 would introduce an obligation to assess the creditworthiness of a consumer seeking to take out a mortgage. Although this policy

option has been found to be highly operational and effective in tackling various problems identified, Option 1.3 (denial of the credit in case of negative creditworthiness assessment) achieves to a greater extent the objectives identified. This is primarily due to the fact that the assessment incorporates the cost and benefits of Option 1.2 as it is not feasible to deny credit without first undertaking a creditworthiness assessment. The effects of Option 1.3 would be substantial since although estimates are that 90 % of creditors currently assess a borrower's creditworthiness, this does not necessarily mean that they decide against giving a loan if the assessment is negative since they may instead decide to rely, for example, on the value of the underlying collateral as the basis for the loan. Option 1.3's positive effects would be however reinforced if combined with Option 1.4 (access to databases), Option 1.5 (homogenisation of databases) and Option 1.6 (borrower disclosure obligations). This is due to the fact that these options broaden the scope of information upon which a creditor conducts a creditworthiness assessment. Despite this, doubts on the feasibility, at least in the short term, of Option 1.5 remain due to the difficulty to agree on the standards for data content and data registration to be applied across the EU.

Table 15: Creditworthiness – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
		Efficient and competitive Single Market with a high level of consumer protection					
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field	Financial stability	
1.1: Do nothing	0	0	0	0	0	0	0
1.2: Requirement for the creditor to assess the borrower's creditworthiness	✓✓	✓✓	✓	✓	✓	✓✓	✓✓
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	✓✓✓	✓✓✓	✓	✓	✓	✓✓✓	✓✓
1.4: Non-discriminatory access to databases for creditors	✓	0	✓	✓✓	✓✓	✓	✓✓
1.5: Homogenise the content and characteristics of databases	✓	0	✓	✓	✓✓	✓	✓
1.6: Requirement for the borrower to provide correct information on his/her situation	✓	0	*	✓✓	✓	✓	✓

6.5.2.2. Suitability assessments

Option 2.1 (Do nothing) is proven ineffective as described in the problem section. Introducing an obligation to systematically assess the suitability of the credit products offered to the consumer (Option 2.2) would address some of the negative consequences of irresponsible

lending and borrowing and bring about gains to both consumers and creditors. However, this option will be more effective if coupled with a requirement to warn borrowers when a particular credit product appears unsuitable to the borrower's needs and circumstances (i.e. Option 2.3 which combines the suitability assessment with a warning to borrowers). Option 2.4 (borrower disclosure of all relevant information) has proven to have a positive impact while not imposing significant costs on the different stakeholders. Option 2.5 (product regulation, e.g. LTV, LTI thresholds), on the other hand, has proven ineffective, in particular because of the potential negative effects on, amongst other things, the diversity of products available, product innovation or lending volumes that this option would entail. In certain forms, this policy option could also lead to the establishment of barriers to the single market and the free flow of capital in the EU.

Therefore the preferred option is therefore a combination of Option 2.3 and Option 2.4, a requirement for borrowers to disclose information. Option 2.4 is the same as Option 1.6 therefore the impacts will be explained only under the section on creditworthiness.

Table 16: Suitability – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure that creditors and borrowers take appropriate lending and borrowing decisions	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
		Improved consumer confidence	Customer mobility	Cross-border activity	A level playing field		
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered	✓✓	✓	✓	✓✓	✓✓	✓✓	✓✓
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	✓✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
2.4: Requirement for the borrower to provide correct information on his/her situation	✓	0	*	✓✓	0	✓	✓
2.5: Specific product regulation including bans or caps on certain credit products	0	✓	0	**	*	0	0

6.5.3. Impact of the preferred options on stakeholders

6.5.3.1. Creditworthiness assessment

Consumers and society at large are likely to benefit from a denial of credit in the event of a negative creditworthiness assessment (Option 1.3) as well as better access to information on

borrowers (Options 1.4 and 1.6) since the probability of default will be reduced⁹⁶. These benefits are estimated as ranging from EUR 30-120 million for Option 1.6 (borrower disclosure) to EUR 187-249 million for Option 1.3. The high level of benefits, despite the fact that estimates are that 90 % of creditors already conduct creditworthiness assessments, is due to the fact that although an assessment is carried out, creditors may decide nevertheless to proceed based on a reliance on the value of the underlying collateral. At the same time, more thorough creditworthiness checks may also have a negative impact on consumers since there is a risk that access to credit for some groups of consumers (e.g. low income) is restricted. If however, the reduced access is for certain groups of borrower regardless of their individual creditworthiness, this would represent a cost. However, reduced access due to a reduction in responsible lending and borrowing would not represent a wider cost to society as it would address the overextension of credit to certain borrowers who may not have been in a position to repay and would have incurred extra charges due to default penalties and higher interest rates. Furthermore, other groups of consumers (e.g. more creditworthy borrowers) may benefit in the form of more appropriate risk based pricing. Consumers would also benefit as the increased confidence would in turn encourage customer mobility. Consumers would also face a minimal cost in terms of time and effort in providing creditors with the relevant information (e.g. salary slips) to make a creditworthiness assessment. A recent study found that creditworthiness checks resulting in 'credit denial' is the most effective option to increase society welfare in the presence of strong interest rate and house price cycles.⁹⁷

Table 17: Creditworthiness – Impact on main stakeholders

	Consumers and society	Creditors and credit intermediaries	Member States
1: Do nothing	0	0	0
2: Requirement for the creditor to assess the borrower's creditworthiness	✓✓	✓	0/*
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	✓✓✓	✓	0/*
1.4: Non-discriminatory access to databases for creditors	✓/0	✓✓	0/*
1.5: Homogenise the content and characteristics of databases	✓✓	✓✓	0
1.6: Requirement for the borrower to provide correct information on his/her situation	✓/0	✓✓	0/*

Given that 90 % of creditors are assumed to already conduct creditworthiness assessments, the incremental costs of the preferred combination of policy options is assumed to be limited: one off costs are estimated at EUR 138 million and annual recurring costs are estimated at EUR 78 million to EUR 123 million. This excludes the costs of non-discriminatory access to databases (Option 2.4) as the costs would depend on the method of access chosen. In practice, these costs would be lower as substantial synergies would be achievable, e.g. regarding training costs, only one training session would be required. Creditors would also face non-quantifiable benefits in the form of a more level playing field across the EU as well as increased opportunities for cross-border business. Under Option 1.4, credit registers would have to adjust their systems and manage cross-border access. These one off and recurring costs are estimated at between EUR 0.1-0.3 million and EUR 0.1-0.2 million respectively.

⁹⁶ For more details on how the costs and benefits in this section (creditworthiness assessment) and the following one (suitability assessment) have been calculated see Annex 4, Section 4.

⁹⁷ See footnote 9, p. 487.

Member States will face costs for introducing rules (in the event of a legislative instrument). Assuming that all 27 Member States would have to introduce at least some of the policy options, costs are estimated at EUR 0.6 million.

6.5.3.2. Suitability assessment

Benefits of EUR 442-553 million for both consumers and society would result from an implementation of Option 2.3 (which incorporates Option 2.2 but is coupled with a warning) the introduction of a requirement to warn consumers as fewer unsuitable products will be sold, reducing the risk of overindebtedness, default and potentially foreclosure. Its positive effects would be reinforced when combined with the obligation for the borrower to provide correct information (Option 2.4). The impacts of a borrower requirement to disclose information (Option 2.4) are however incorporated in the previous section.

Table 18: Suitability – Impact on main stakeholders

	Consumers and society	Creditors and credit intermediaries	Member States
1: Do nothing	0	0	0
2.2: Requirement for the creditor or the credit intermediary to assess the suitability of the product offered	✓✓	✓	×
2.3: Requirement to warn the borrower if the chosen credit product is not suitable	✓	✓	×
2.4: Requirement for the borrower to provide correct information on his/her situation	0	✓✓	0
2.5: Specific product regulation including bans or caps on certain credit products	0/✓	××	××

Creditors and credit intermediaries would face implementation costs. Those creditors that are currently not carrying out suitability assessment would need to build up respective systems and procedures from scratch. It is estimated that creditors and credit intermediaries will face one off costs of EUR 337 million and annual recurring costs of EUR 82 million.

An EU requirement to carry out suitability assessments will not introduce changes in a number of Member States: 13 Member States⁹⁸ require already specific risk warnings to be issued to consumers (and it can be assumed that some kind of suitability assessment has therefore been conducted beforehand). One-off costs to Member States are estimated at EUR 0.3 million and annual recurring costs at EUR 0.3-1 million.

6.6. Early repayment

A detailed description of all the policy options and an assessment of their effectiveness and efficiency are contained in the impact assessment accompanying the White Paper on the integration of EU mortgage markets⁹⁹, which concluded that the liberalisation of early repayment regimes (contractual option) but with a right to early repayment in certain circumstances or a compulsory right to early repayment combined would be most effective in achieving the objectives.

⁹⁸ Member States with legal requirements: Bulgaria, Cyprus, Denmark, Greece, France, Hungary, Ireland, Netherlands, Poland, Portugal, Romania, Sweden and the UK. Member States with self-regulation: Germany and Estonia.

⁹⁹ SEC(2007) 1683, Annex III, p. 55-80 and corresponding IAB Opinion, SEC(2007) 1685.

The *Study on the costs and benefits of different policy options for mortgage credit* by London Economics with Achim Dübel (Finpolconsult) in association with the institute für finanzdienstleistungen (iff)¹⁰⁰ subsequently calculated the costs and benefits of the different policy options, concluding that the net present value of introducing a right to early repayment (with no grandfathering, i.e. the impact on the existing portfolio of mortgages remains unchanged) would result in net benefits for the EU27 of between EUR 7 273 million to EUR 18 540 million compared to the baseline of the status quo and depending on the compensation regime adopted.¹⁰¹ This compares to net benefits for the EU27 of EUR 2 211 million compared to the baseline of the status quo for a partial contractual option.¹⁰²

6.7. Credit intermediaries

6.7.1. Available options

Table 19 gives an overview of the policy options for credit intermediaries. Two main problem areas have been identified: registration and authorisation; and prudential requirements and supervision. Each area consists of a number of policy options. A detailed description of the options and an assessment of their effectiveness and efficiency are in Annex 4, Section 5.

Table 19: Credit intermediaries – Policy options

Policy option
Authorisation and registration
1.1: Do nothing
1.2: Principles-based requirements
1.3: Specific requirements
1.4: Introduce a passport
Prudential requirements and supervision
2.1: Do nothing
2.2: Principles-based requirements
2.3: Specific requirements
2.4: Introduce EU level supervision

6.7.2. Comparison of options

6.7.2.1. Authorisation and registration

With Option 1.1 (Do nothing) the problems identified will remain and the objectives will not be achievable. On the one hand, Option 1.3 (principles-based authorisation and registration requirements) is more effective than Option 1.2 (rules specifying the conditions for authorisation and registration) in achieving the objectives of improving consumer confidence and promoting both cross-border activity and a level playing field. In addition, research has showed that intermediation overcharging is the source of consumer detriment most reduced by a higher regulatory environment¹⁰³. Finally, Option 1.4 (EU passport) is considered to be the most effective in promoting cross-border activity and ensuring a level playing field between all players. The preferred policy options are therefore a combination of Options 1.3, which achieves the right balance between effectiveness and efficiency, and 1.4.

¹⁰⁰ See footnote 9, p. 200-336, and Annex D.

¹⁰¹ See footnote 9, p. 319.

¹⁰² See footnote 9, p. 319.

¹⁰³ See footnote 57, p. 177, Figure 5.19.

Table 20: Authorisation and registration of credit intermediaries – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure appropriate regulatory regime for credit intermediaries to integrate the Single Market	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
Improved consumer confidence		Customer mobility	Cross-border activity	A level playing field			
1: Do nothing	0	0	0	0	0	0	0
2: Principles-based requirements	✓✓	✓	0	✓	✓	✓✓	✓
1.3: Specific requirements	✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓✓
1.4: Introduce a passport	✓✓	0	0	✓✓✓	✓✓✓	0	✓✓

6.7.2.2. Prudential requirements and supervision

The 'Do nothing' scenario will entail status quo and would not contribute to any of the policy objectives. Option 2.2 (principles on proportionate prudential requirements and supervision) is expected to contribute to the objective of improving consumer protection in Member States with no rules in place for credit intermediaries. Option 2.2 will also contribute to achieving the objective of on tackling cross-border mobility while contributing to the creation of a level playing field between all market players will be limited to the 'national level' as EU rules will continue to differ. Option 2.3 (specific rules for the prudential requirements and supervision) is expected to have a greater impact on the objective of consumer protection than principles-based rules, as the level of consumer protection will be equal across all Member States. In addition, this option will have a more positive impact on cross-border mobility of credit intermediaries and will better create a level playing field between all providers, since it would generate more legal certainty as the same specific rules would need to be applied in all Member States. While Option 2.4 (EU supervision) would address regulatory gaps in prudential requirements and supervision, in view of the currently limited level of cross-border activity of credit intermediaries, the establishment of a supervisory authority appears as a disproportionate measure.

While Option 2.3 appears to be more effective in reaching many of the objectives, Option 2.2 is considered more efficient as not all Member States would be required to change their rules. In addition, in view of the limited market share of credit intermediaries, the introduction of principles-based prudential requirements could be considered more proportionate. Therefore, Option 2.2 is the preferred option.

Table 21: Prudential requirements and supervision of credit intermediaries – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure appropriate regulatory regime for credit intermediaries to integrate the Single Market	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
Improved consumer confidence		Customer mobility	Cross-border activity	A level playing field			
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Principles-based requirements	✓✓	✓✓	0	✓	✓	✓✓	✓✓
2.3: Specific requirements	✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓
2.4: Introduce EU level supervision	✓	✓	✓	✓	✓	✓	✓

6.7.3. Impact of the preferred options on stakeholders

6.7.3.1. Authorisation and registration

Option 1.3 will bring benefits to consumers as the introduction of authorisation and registration requirements are expected to increase consumer protection and reduce default levels by consumers as credit intermediaries provide more responsible credit¹⁰⁴. The benefits are estimated at EU 40-80 million in reduced value of defaults. Likewise, it can be expected that creditors will also be able to rely more on the credit intermediaries they work with and that they would face a lower reputational risk. Option 1.4 is expected to increase the availability of credit intermediation services on the market, consumer choice and competition between providers, which eventually could result in better prices for consumers and more cross-border business opportunities for creditors.

In terms of costs for credit intermediaries, Option 1.3 is expected to generate one-off costs of EUR 20 million and recurrent costs of nearly EUR 17 million. These costs are slightly higher than under Option 1.2 since the number of Member States and credit intermediaries that would have to amend their systems is increased. However, the net benefits of Option 1.3 are higher than those of Option 1.2.

Table 22: Authorisation and registration of credit intermediaries – Impact on main stakeholders

	Consumers and society	Credit intermediaries	Creditors	Member States
1.1: Do nothing	0	0	0	0
1.2: Principles-based requirements	✓✓	*/0	✓	*/0
1.3: Specific requirements	✓✓✓	***/*	✓✓	*/0
1.4: Introduce a passport	✓	✓✓	✓	*/0

Regarding Member States, the one-off costs for public authorities to implement Option 1.2 are approximately EUR 0.9 million and recurring costs are estimated at EUR 1.6 million to

¹⁰⁴ For more details on how the costs and benefits in this section (authorisation and registration) and the following one (prudential requirements and supervision) have been calculated see Annex 4, Section 5.

ensure the authorisation process in those Member States without requirements in place. As such for Member States economies, the increased market stability is expected to be a positive effect from all options except for the status quo.

6.7.3.2. Prudential requirements and supervision

Under Option 2.2, the introduction of prudential requirements will increase responsible lending behaviour and contribute to reduction of default levels. Therefore, it will have a positive impact on consumers in the range of EUR 19-51 million.

Table 23: Prudential requirements and supervision of credit intermediaries – Impact on main stakeholders

	Consumers and society	Credit intermediaries	Creditors	Member States
2.1: Do nothing	0	0	0	0
2.2: Principles-based requirements	✓✓	*	✓	*/0
2.3: Specific requirements	✓✓✓	xx/x	✓✓	x/0
2.4: Introduce EU level supervision	✓	0	✓	x/0

Option 2.2 will generate compliance costs for credit intermediaries only in those Member States with currently no rules in place. These costs are estimated at EUR 17.7 million annually. For Member States, the main impact of Option 2.2 is an improvement in market stability through better supervision, especially in markets where no supervision is currently conducted. However, in those Member States¹⁰⁵, the introduction of supervision will create one-off costs of EUR 0.5 million and recurring costs of EUR 1.6 million.

6.8. Non-credit institutions providing mortgage credit

6.8.1. Available options

Table 24 provides an overview of the policy options for NCIs. Two main problem areas have been identified: registration and authorisation; and prudential requirements and supervision. Each area consists of a number of policy options. A detailed description of the options and an assessment of their effectiveness and efficiency are in Annex 4, Section 6.

¹⁰⁵ Namely: Cyprus, Lithuania, Latvia, Cyprus, Slovakia, Romania, Poland, Spain, Sweden, Finland, Denmark, Belgium, Estonia, France, Greece, Czech Republic, Italy, Bulgaria, Slovenia and Portugal.

Table 24: NCIs – Policy options

Policy option
Authorisation and registration
1.1: Do nothing
1.2: Principles-based requirements
1.3: Specific requirements
1.4: Introduce a passport
Prudential requirements and supervision
2.1: Do nothing
2.2: Principles-based requirements
2.3: Specific requirements
2.4: Introduce EU level supervision

6.8.2. Comparison of options

6.8.2.1. Authorisation and registration

The objectives regarding authorisation and registration of NCIs cannot be achieved by the status quo scenario, as all the problems would continue to exist. Option 1.2, creating a principles-based regime for authorisation and registration of NCIs, contributes to ensuring an appropriate regime for the registration and authorisation of NCIs. More particularly, this option is effective in meeting the objective of improving consumer protection and consumer mobility and is more effective than the 'Do nothing' option with regard to achieving the objectives of ensuring a level playing field and ensuring a harmonised and proportionate registration and authorisation. However, this scenario is not as effective as Option 1.3 (specific rules for authorisation and registration) to tackle barriers to cross-border mobility, as NCIs willing to operate cross-border would continue to have to comply with distinct national rules. Option 1.3 has been estimated slightly more effective in increasing consumer protection and promoting cross-border activity than principles-based rules. Finally, Option 1.4 (EU passport) is considered to be the most effective in promoting cross-border activity and ensuring a level playing field between all NCIs and other creditors.

However, although Option 1.3 is slightly more effective, Option 1.2 is considered a more proportionate response to varied national markets. A tailor-made authorisation and registration process, corresponding to the local market situation, based on commonly agreed principles appears to be most effective as in some Member States, such as the UK, Netherlands and Belgium, the market share of NCIs can be considered material, while in other Member States, NCIs' market share is small or NCIs are not present on the market at all.

Table 25: Authorisation and registration of NCIs – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure appropriate regime for uptake, pursuit and supervision of NCIs	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
Improved consumer confidence		Customer mobility	Cross-border activity	A level playing field			
1.1: Do nothing	0	0	0	0	0	0	0
1.2: Principles-based requirements	✓✓	✓✓	0	0	✓	✓✓	✓✓
1.3: Specific requirements	✓	✓✓✓	✓	✓✓	✓✓	✓✓	✓
1.4: Introduce a passport	✓	0	0	✓✓✓	✓✓	0	✓

6.8.2.2. Prudential requirements and supervision

With regard to prudential requirements and supervision, the status quo scenario (Option 2.1) is expected to bring no positive effects and will maintain the existing patchwork of prudential requirements and supervision.

Introducing principles-based rules (Option 2.2) will contribute to the objective of improving consumer protection in Member States with no rules in place. As a result, the risks of non-supervised NCIs entering the market, gaining market share and causing consumer detriment will be minimised by proportionate prudential requirements and supervision. However, Option 2.2 will not contribute to achieving the objective of tackling cross-border mobility as the continued absence of a true level playing field will prevail. The introduction of specific rules (Option 2.3) is expected to have a greater impact on the objective of consumer protection than principles-based rules, as the level of consumer protection will be equal across all Member States. This option will also have a more positive impact on the cross-border mobility of NCIs and will better create a level playing field between all providers since it would generate more legal certainty as the same specific rules would need to be applied in all Member States. However, Option 2.3 is less cost-efficient in comparison with principles-based rules (Option 2.2) as it would request all Member States to adapt their rules and supervisory framework to the EU rules, whereas under Option 2.2, only some Member States would have to modify their frameworks. While Option 2.4 (EU supervision) would address regulatory gaps in prudential requirements and supervision, in view of the currently limited level of cross-border activity of credit intermediaries, the establishment of a supervisory authority appears as a disproportionate measure.

Overall, while the introduction of specific rules (Option 2.3) might be more efficient in creating an appropriate legal framework for the supervision of NCIs, in view of the limited market share of and cross-border activity by NCIs, the introduction of principles-based rules (Option 2.2) is considered more proportionate to achieve the objective at this point in time.

Table 26: Prudential requirements and supervision of NCIs – Comparison of options

	Effectiveness in achieving the objectives below						Efficiency in achieving objectives
	Specific objectives	General objectives					
	Ensure appropriate regime for uptake, pursuit and supervision of NCIs	Efficient and competitive Single Market with a high level of consumer protection				Financial stability	
Improved consumer confidence		Customer mobility	Cross-border activity	A level playing field			
2.1: Do nothing	0	0	0	0	0	0	0
2.2: Principles-based requirements	✓✓	✓✓	✓	0	✓	✓✓	✓✓
2.3: Specific requirements	✓	✓✓✓	✓	✓	✓✓	✓✓	✓
2.4: Introduce EU level supervision	✓	0	0	✓✓✓	✓✓	0	✓

6.8.3. Impact of the preferred options on stakeholders

6.8.3.1. Authorisation and registration

Option 1.2, ensuring the introduction of principles-based rules on authorisation and registration of NCIs, is expected to bring benefits to consumers of EUR 1.6-3.2 million by limiting the possibility of irresponsible behaviour by NCIs, thus increasing consumer protection and reducing default levels.¹⁰⁶ Under Option 1.2, authorisation and registration requirements will only require the introduction or modification of a framework in only six Member States¹⁰⁷. NCIs are expected to be subject to one-off costs of EUR 0.7 million and annual recurring costs of EUR 0.7 million. The costs for Member States of implementing Option 1.2 include one off costs of EUR 0.3 million and recurring costs of EUR 0.1 million.

Table 27: Authorisation and registration of NCIs – Impact on main stakeholders

	Consumers and society	Non-credit institutions	Member States
1.1: Do nothing	0	0	0
1.2: Principles-based requirements	✓✓	*/0	*/0
1.3: Specific requirements	✓✓/✓✓✓	*x/x	*/0
1.4: Introduce a passport	✓	✓	*/0

6.8.3.2. Prudential requirements and supervision

The introduction of principles-based prudential requirements and supervision (Option 2.2) should contribute to more responsible behaviour by NCIs and thus benefit consumers. This option should create benefits ranging from EUR 1.3 million to EUR 6.5 million in value of reduced defaults. The introduction of prudential and supervisory requirements under Option 2.2 are expected to generate annual recurring costs for NCIs of EUR 0.7 million. The actual level of costs will depend though on the transposition of the principles into national law. Member States will benefit from greater market stability due to more responsible NCIs. Those Member States which currently have no rules in place, will however need to set up

¹⁰⁶ For more details on how the costs and benefits in this section (authorisation and registration) and the following one (prudential requirements and supervision) have been calculated see Annex 4, Section 6.

¹⁰⁷ Cyprus, Czech Republic, Denmark, Estonia, Finland and Latvia.

prudential supervision process which is expected to generate a one-off costs of EUR 0.2 million and annual recurring costs of EUR 0.1 million.

Table 28: Prudential requirements and supervision of NCIs – Impact on main stakeholders

	Consumers and society	Non-credit institutions	Member States
2.1: Do nothing	0	0	0
2.2: Principles-based requirements	✓✓	*	*/0
2.3: Specific requirements	✓✓✓	**/*	*/0
2.4: Introduce EU level supervision	✓	0	*/0

6.9. Cumulative impacts, impacts on stakeholders and administrative burden

6.9.1. Cumulative impacts

This report concludes that the package of preferred policy options is necessary to ensure responsible lending and borrowing throughout the EU. Measures such as the requirement to deny credit in the event of a negative creditworthiness assessment and to warn borrowers if they are purchasing a product that is considered to be unsuitable, as well as measures to ensure the relevant authorisation, registration and supervisory requirements are in place would help to ensure that creditors operate in a responsible manner. However, while encouraging responsible lending, such policies on their own would not avoid all irresponsible lending, nor would ensure responsible borrowing or prevent consumers from being locked into unsuitable products. That is why other policies are equally needed, such as policies to improve the quality and comparability of advertising and marketing materials as well as comprehensive and relevant pre-contractual information, and adequate explanations and advice. These policies would ensure that borrowers are in a position to choose a mortgage product suited for their needs. Furthermore, measures will also be necessary in order to ensure that the consumer and not just the creditor is responsible for the decision. This in line with the opinions of stakeholders who have emphasised that the final choice of product should be with the consumer.

The preferred options should produce a substantial improvement in terms of a reduction of consumer detriment. They will improve consumer confidence in creditors, credit intermediaries and mortgage products and will reduce the likelihood of consumers purchasing an unsuitable product, which could potentially lead to overindebtedness, default and eventually foreclosure. The estimated monetary value of these benefits is substantial as indicated in Table 29. It should however be emphasised that these benefits are not always cumulative since the number of consumers purchasing an unsuitable product is constant and they may benefit from several individual policy options. The strong positive effect on consumer confidence is also expected to underpin the demand for credit products and encourage consumer mobility both at national and, albeit to a lesser extent, cross-border level. These last effects could however not be quantified due to the difficulty to model consumer behaviour.

The implementation of some of the retained options will not lead to significant changes to the operation of market actors on the supply side in a number of Member States, where similar obligations already exist. For example, it is assumed that the large majority (90 %) of creditors already conduct a creditworthiness assessment. However, the preferred policy options will have an important impact on the cross-border activity of creditors and credit intermediaries. The implementation of the preferred options regarding advertising and marketing, pre-contractual information, advice, creditworthiness and suitability assessments,

credit intermediaries and NCIs by levelling the playing field between the players from different Member States will encourage cross-border activity by offering new business opportunities as well as economies of scale and scope. This will have a positive impact both on the market players and for consumers. The entry of foreign credit providers and credit intermediaries should strengthen competition and, thus, translate in a wider range of credit products for the consumer and potentially even a marginal decrease in prices. The preferred policy options will also entail costs for creditors and credit intermediaries. However, these costs will be limited by several factors. First, a number of the preferred policy options are already implemented in several Member States. Second, according to contributions from industry, many of the preferred policy options are already common practice amongst large parts of industry. Third, substantial synergies are expected between the different policy options. For example, each policy option's estimated costs includes the cost of training, however in practice these training can be combined into a single or two day session. Similarly costs for Member States can benefit from substantial synergies as the costs of adopting several provisions would not be much more than adopting one.

The impacts of some of the chosen options will just add up, e.g. the obligation to provide the ESIS and the need for credit intermediaries to be registered. However, it can be anticipated that other options will reinforce each other. This is for example the case of the option on adequate explanations and that on the improvement of the ESIS content, as well as of the option imposing requirements regarding creditworthiness and suitability assessments. In the first case, it is expected that both options would have a positive impact on the financial literacy of the borrower, who will find in the future easier to understand credit information materials and therefore to protect better his/her own interest. In the second case, for creditors carrying out both creditworthiness and suitability assessments, cost savings can be expected since the information required for one assessment could be useful for the other.

Table 29 gives an overview of the cost benefit analysis carried out by Commission services. As indicated above, the cumulative impact cannot be calculated as a simple sum of individual impacts. This is due not only to the risk of double counting overlapping costs and benefits, but also because of the synergies between some options that should amplify their impact. The calculation of the cumulative benefits of the retained options (EUR 1 272-1 931 million) has been undertaken on the following basis: in order to avoid overlaps, for each topic (advertising and marketing, pre-contractual information, advice and explanations, etc.) only the benefits from the option with the higher potential benefits have been included in the cumulative impact (e.g. for the 'advice and explanations' topic only the benefits of Option 2.2 have been taken into account in the calculation of the cumulative benefits). This is prudent approach which most likely underestimates the potential beneficial impact of the package. The calculation of the cumulative costs of the retained options has been undertaken on the following basis: for credit intermediaries and NCIs, it is believed that the estimated figures for each option do not include overlapping costs or synergies, consequently the costs of all retained options have been added; for the remaining topics (advertising and marketing, pre-contractual information, advice and explanations and creditworthiness and suitability) only the costs from the option with the higher potential costs have been included in the cumulative impact (e.g. for the topic 'advice and explanations' only the costs of Option 1.3 have been taken into account in the calculation of the cumulative costs). It is therefore assumed that for these latter topics, the costs are in the majority of cases overlapping for a given policy area.¹⁰⁸

¹⁰⁸ E.g. training cost, IT cost and other compliance costs for the different options within the same policy area are in most cases overlapping.

The costs and benefits of policy options for early repayment are subject to a separate cost-benefit analysis¹⁰⁹ and are therefore not included in this analysis. Thus, the expected total one-off and ongoing costs of the policy options chosen are in the range of EUR 383-621 million and of EUR 268-330 million respectively. For information on methodology see Annex 5.

¹⁰⁹ See footnote 9, p. 200-336, and Annex D.

Table 29: Costs and benefits of preferred policy options (EUR million)

	Consumer/society benefits: reduction in defaults (value of mortgages) ¹¹⁰	Creditor and credit intermediary costs		Member State costs	
		One-off costs	Recurring costs	One-off costs	Recurring costs
Advertising and marketing					
3: Specific rules	124-187	51	0	0.6	0
Pre-contractual Information					
3.2: Specify a deadline for the provision of information	337-611	185	151	0.6	0.7-2
4: Improve the format and content of the ESIS	311-436	185	151	0.6	0.7-2
5.2: Standardisation of the APRC on the basis Article 19 of the CCD	124-229	96	78	0.3	0.1-1
6: Additional pre-contractual information	124-229	185	151	0.6	0.7-2
Advice and explanations					
1.2: Requirement to provide adequate explanations (Article 5(6) of CCD)	40-56	25	13-25	0.2	0.2-0.5
1.3: Principles-based advice standards	58-77	30	15-30	0.1	0.5
2.2: Principles-based guidance on remuneration policies	349-523	3	0	0.6	0
Creditworthiness and suitability					
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	187-249	104	11	0.4	0.2-0.3
1.4: Non-discriminatory access to databases for creditors	123-205	N/A	N/A	0.2	0
1.6: Requirement for the borrower to provide correct information on his/her situation	60-120	34	67-112	0.4	0
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	442-553	337	82	0.3	0.3-1
Credit intermediaries					
1.3: Specific requirements for authorisation and registration	20.0-41.1	15.5	12.9	0.9	1.6
2.2: Principles-based requirements on prudential requirements and supervision	19-51	—	17.7	0.5	1.6
1.4: Introduce a passport ¹¹¹	Not quantified ¹¹²	—	—	—	—
Non-credit institutions providing mortgage credit					
1.2: Principles-based requirements on authorisation and registration	1.6-3.2	0.7	0.7	0.3	0.1
2.2: Principles-based requirements on prudential requirements and supervision	1.3-6.5	-	0.7	0.2	0.1
Total	1 272-1 931	381-619	266-325	1.8-2.8	2.4-4.7

6.9.2. Geographical impacts

Most of the preferred options' impacts will be spread across the EU. However, for some options, the benefits and costs will be amplified in those Member States which will need to substantially adapt the rules in place or introduce a complete regulatory framework (e.g. in those countries where credit intermediaries or NCIs are not regulated at all). This has been clarified in the different sections of the analysis. In addition, when data was available, regional aspects have been taken into account and discounts have been applied in the

¹¹⁰ While costs directly reduce providers' revenues, the benefits termed 'reduction in defaults' are not revenues; they are assets that are expected to generate revenues in the form of interest received.

¹¹¹ No incremental costs for credit intermediaries and Member States as these are assumed to be part of the principles-based rules on authorisation and registration.

¹¹² Increased cross border trade is expected, but in view of lack of data this is not quantified.

quantification of the overall costs and benefits¹¹³. Table 30 shows the Member States that should be least impacted by those policy options whose implementation is expected to have more heterogeneous geographical effects. Other chosen options, such as improving the content and format of the ESIS or the introduction of a passport for credit intermediaries are expected to have an impact on all Member States. The latter policy options are not included in Table 30.

Table 30: Policy options expected to impact differently Member States

Policy option	Least impacted Member States
Pre-contractual Information	
3.2: Specify a deadline for the provision of information	Austria, Belgium, Germany, Denmark, Estonia, Greece, Finland, Hungary, Luxembourg, Malta, Netherlands, Portugal, Sweden, Slovakia ¹¹⁴
5.2: Standardisation of the APRC on the basis Article 19 of the CCD	Austria, Cyprus, Germany, Denmark, Estonia, Spain, France, Hungary, Italy, Malta, Romania, Slovenia, Sweden
Advice and explanations	
1.2: Requirement to provide adequate explanations (Article 5(6) of CCD)	Austria, Belgium, Czech Republic, Germany, Denmark, Estonia, Greece, Spain, Finland, Hungary, Ireland, Italy, Latvia, Malta, Netherlands, Portugal, Romania, Slovenia, Sweden, Slovakia
1.3: Principles-based advice standards	Austria, Cyprus, Germany, Denmark, Estonia, Finland, France, Hungary, Ireland, Italy, Latvia, Netherlands, Poland, Portugal, Sweden, Slovakia, UK
Creditworthiness and suitability	
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	Cyprus, Czech Republic, Germany, Estonia, France, Netherlands, Poland, Sweden, UK
1.4: Non-discriminatory access to databases for creditors	Austria, Belgium, BG, Cyprus, Germany, Denmark, Estonia, Spain, Finland, Hungary, Italy, Latvia, Malta, Netherlands, Romania, Sweden, Slovenia, UK
1.6: Requirement for the borrower to provide correct information on his/her situation	Bulgaria, Czech Republic, Germany, France, Ireland, Latvia, Netherlands, Poland, Portugal, UK
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	Bulgaria, Cyprus, Denmark, Greece, France, Hungary, Ireland, Netherlands, Poland, Portugal, Romania, Sweden, Slovakia
Credit intermediaries	
1.3: Specific requirements for authorisation and registration	Austria, Hungary, Ireland, Malta, Netherlands, UK
2.2: Principles-based requirements on prudential requirements and supervision	Austria, Hungary, Ireland, Malta, Netherlands, UK
Non-credit institutions providing mortgage credit	
1.2: Principles-based requirements on authorisation and registration	Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Spain, Finland, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Romania, Slovenia, Sweden, UK
2.2: Principles-based requirements on prudential requirements and supervision	Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Spain, Finland, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Romania, Slovenia, Sweden, UK

6.9.3. Social impacts

The main benefits to consumers and society as a whole come through a reduction in defaults. However, two other different potential social impacts can be identified.

On the one hand, there is a risk that responsible lending practices may result in reduced access to credit, particularly for certain groups of borrowers (e.g. with a low income). Reduced access for certain groups regardless of individual creditworthiness would be a cost, however

¹¹³ The quantification and detailed analysis of geographical impacts is beyond the scope of this assessment. However this report and its Annexes contain the elements to enable such assessment.

¹¹⁴ While these Member States have not yet a specific deadline for the provision of the ESIS, the implementation of the code of conduct is over 90 %.

reduced access due to a reduction in irresponsible lending would not represent a wider cost to society as it would address the overextension of credit to certain borrowers who may not have been in a position to repay, and would have incurred extra charges due to default penalties and higher interest rates. Certain groups of borrowers may be more impacted than others, for example, borrowers with impaired credit histories, or self-employed borrowers who may struggle to provide documentation to verify income. However the precise impact of these measures would depend on exactly how creditworthiness is assessed by creditors; which is left to Member States to determine. Consequently, the most vulnerable consumers will be protected from overindebtedness, not excluded from access. By doing so, this may spur a demand for alternative forms of housing, such as social housing and rental accommodation. These aspects fall largely beyond the scope of EU competencies and should be pursued by Member States at a national, or even regional, level.

In the UK, a study has recently been published on the impact of proposals to introduce a requirement to assess affordability.¹¹⁵ Although the FSA proposals go further than the proposed policy option, in particular in specifying how affordability should be assessed, the results give an indication of the possible consequences of a requirement to assess creditworthiness. The research states that "around 10 % of existing mortgages would not pass the new tests". It should be underlined that, due to the differences between the UK mortgage credit market and other EU markets, the impact on access to credit is likely to be less significant elsewhere in the EU as not only are the proposals far more detailed than those considered in this impact assessment, but the UK market has a different product range from other markets, and as such products which exist in the UK are not necessarily widespread elsewhere in the EU, e.g. self-certified mortgages. On the other hand, responsible lending policies enhance the social sustainability of lending practices and thus social cohesion. This is done by reducing the number of potential defaults and avoiding, in the worst case, foreclosures. Enhanced access to information on the borrower should also allow creditors to better price their products and enlarge their credit offer. Thus, mortgage credit may be available to some consumer groups (e.g. foreign consumers) that were originally turned down by creditors.

Finally, social impacts can be expected at the level of market players' staff. As explained in Annex 4, restrictions to remuneration policies could have an impact on how employees and credit intermediaries are remunerated. The implementation of the other options should have a positive effect on staff in the form of more training and possible job creation.

6.9.4. *Administrative burden*

Our assessment of the various policy options is that for most of the retained options no increase of the administrative burden is expected. This is particularly the case of the advertising and advice preferred options, which introduce conduct of business rules but do not imply any obligation to provide information on the way they are implemented (see Annex 4, Sections 1 and 3). Neither the chosen options in relation of the creditworthiness and suitability assessments should increase the administrative burden of the financial services industry or consumers. There are two exceptions to this, first, the obligation for the credit provider or credit intermediary to warn the client if the product chosen by the later seems unsuitable. Second, the obligation for the borrower to provide correct information, but only

¹¹⁵ *Assessment of compliance costs and indirect costs as a result of the MMR lending reforms*, Oxera, 7.7.2010.

when this is provided in the form of statements or certificates. Nevertheless, the analysis has demonstrated that the increase of administrative burden due to both these possibilities is relatively small (see Annex 4, Section 4). In the case of the ESIS options, an increase of the administrative burden is foreseen for those creditors that do not yet provide the ESIS or any other similar information material imposed by national laws. However, as shown above, the benefits clearly outweigh the costs (see Annex 4, Section 2).

There are two issues for which more important administrative burdens can be expected: credit intermediaries and NCIs. The costs linked to the authorisation and registration of these market players, although mostly one-off in nature, will imply a significant administrative burden on those players¹¹⁶. In the case of credit intermediaries, the costs of ongoing compliance with the new legislation (EUR 13 million for authorisation and registration, and EUR 17.7 million for prudential supervision), while including other non-administrative costs, provides a good estimate of the overall envelope within which administrative burden for these actors can be seen. For non-banks, since the retained option is less prescriptive about the framework that should be imposed to them, the administrative burden will depend on the approach chosen by Member States. The information obligations originating at the national level are therefore not quantified. As such, all requirements for information provision are accounted for.

6.9.5. *Other impacts*

The introduction of the preferred policy options will not lead to discrimination against creditors or credit intermediaries from third countries willing to offer their services on the EU territory as they would need to comply with the same rules. If the proposed measures are extended to the three EEA countries which are not members of the EU, the same impacts would be felt in Iceland, Liechtenstein and Norway. No direct impact on other countries is to be expected.

On the contrary, the preferred policy options are in line with work on mortgage reform across the globe. Recognising the role of regulatory failures in the financial crisis, the G20 stated that it would ensure "that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances", and that "the appropriate bodies should review the differentiated nature of regulation in the banking, securities and insurance sectors and provide a report outlining the issue and making recommendations on needed improvements".¹¹⁷ The body authorised to carry out this review, the Joint Forum, found that "poorly underwritten residential mortgages contributed significantly to the financial crisis" and made a series of recommendations, including that "supervisors should ensure that mortgage originators adopt minimum underwriting standards that focus on each borrower's capacity to repay the obligation in a reasonable period of time" and that "policymakers should ensure that different types of mortgage providers, whether or not currently regulated, are subject to consistent mortgage underwriting standards, and consistent regulatory oversight and enforcement to implement such standards".¹¹⁸ The report recognised that each country's mortgage industry is shaped by distinct real estate markets, cultural influences and socioeconomic policies, but set out a goal that similar products and activities be subject to consistent regulation, standards and examination. In responding to these recommendations,

¹¹⁶ No other costs vis-à-vis third parties are expected.

¹¹⁷ See footnote 20.

¹¹⁸ The Joint Forum brings together global banking, insurance and investment supervisors to address issues of relevance across the three financial sectors. *Review of the Differentiated Nature and Scope of Financial Regulation*, Joint Forum, January 2010, p. 17.

the Financial Stability Board launched a thematic review of mortgage origination practices in its member countries, which constitute the vast majority of developed economies. Its objective is to provide a comprehensive picture of existing practices in the areas of mortgage credit origination and to draw internationally applicable lessons where possible.

Initiatives have also been launched across the globe to improve the quality of mortgage origination. In the US, authorities clearly recognised the catalytic role that irresponsible lending had played in setting off the financial crisis, stating that "the financial crisis was triggered by a breakdown in credit underwriting standards in subprime and other residential mortgage markets"¹¹⁹. The legislative text that followed is known as the Dodd-Frank Act¹²⁰ and contains provisions to address the problems evident in the US market. It introduces a number of requirements that mirror closely those proposed in this Impact Assessment, including a requirement that lenders undertake a creditworthiness assessment of the consumer, a prohibition on incentives that encourage lenders to steer the consumer towards loans at a higher interest rate than they may actually have qualified for and a requirement for information to consumers to disclose risky features such as variable rates. The US Treasury is currently developing new mortgage disclosure forms, which should result in the provision of information to consumers in a single, clear, easy to understand and comparable document, following the model of the ESIS. At the time of writing, this disclosure document is still in the planning stage, and has not yet been designed, tested or implemented.

The preferred policy options do not have any impact on Community resources and no significant impacts on the environment can be expected from these policy options.

6.10. Choosing the most appropriate policy instrument

Action at the EU level must respect the principle of proportionality. The proportionality of a proposed measure would in essence depend on several considerations:

- The choice of the instrument: this is crucial in finding an appropriate balance between EU level action and national action. Self-regulation, a Recommendation, Directive or Regulation would all have different impacts on the proportionality of the measures chosen.
- If a legislative instrument (Directive or Regulation) is chosen, proportionality can be taken into account in choosing the right combination of principles-based measures and more specific requirements. A key issue is to ensure to the largest extent possible that the level of consumer protection is not reduced. Further attention to the proportionality principle is evident, as described above, in the fact that several policy options refer to the possibility of implementing measures or technical standards at a later stage.

For each of the policy options, a wide range of potential policy instruments including self-regulation, non-binding measures (Communication and Recommendation) and binding measures (Directive or Regulation) were considered. The idea of a Communication was discarded at an early stage for all policy options. A Communication is a tool used to

¹¹⁹ Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation, US Department of the Treasury, 17.6.2009, p. 45.

¹²⁰ Wall Street Reform and Consumer Protection Act.

communicate information to Member States, in contrast to the rest of the instruments that, once adopted, effect a particular change in the way things are done.

6.10.1. Self-regulation

The establishment of rules on the registration, authorisation and supervisory regimes for credit intermediaries and NCIs requires a legal act either on a national or EU level. Consequently, self-regulation would not be effective in these instances.

The remaining preferred policy options for advertising and marketing, pre-contractual information, advice, and creditworthiness and suitability, could theoretically all be pursued through the use of self-regulation. In practice, though several aspects would limit its effectiveness and efficiency. First, self-regulation is meant to be flexible and inexpensive. Experience has shown however that reaching agreement between the different stakeholders, in particular consumers and industry representatives, is extremely difficult due to the divergence of opinions. Negotiations are long, and resource consuming. Given their shortage of resources, this problem is particularly acute for consumer representatives. Second, for self-regulation to be successful, adherence and implementation of the agreed code/rules must be near the 100 % level that exists in the case of binding legislation. Given the experience with the adherence and implementation of the *Voluntary Code of Conduct on Pre-Contractual Information for Home Loans*, it is unlikely that such adherence and implementation levels are achievable. Some providers may refrain from signing a Code, while others may be unable to do so for fear of contravening national legislation, and others may sign but inadequately apply it. Finally, while some of the policy options can in theory be achieved through self-regulation, the fact that they are already regulated by law in some or all Member States means that self-regulation would be ineffective (e.g. for the APRC or early repayment) or lead to a dual burden on creditors (e.g. two sets of information sheets to be provided – one under national rules and one under EU rules). These deficiencies neutralise the benefits of self-regulation. It is therefore unlikely that self-regulation will be an effective instrument in the achievement of the objectives.

6.10.2. Non-binding measures: Commission Recommendation

A Recommendation to Member States could in theory give effect to all the policy options. But some Member States may refrain from implementing the recommendation and others may be reluctant to amend and/or abolish existing national provisions. It follows that implementation is unlikely to reach at or near the 100 % level. This will result in a somewhat partial achievement of the objectives pursued under this initiative, with the extent of success largely dependent on how many Member States would decide to implement the Recommendation.

6.10.3. Binding measures: Directive or Regulation

The introduction of a Directive or Regulation is the most effective and efficient way of achieving the set objectives. Only a binding legislative instrument can guarantee that the policy options are introduced in all 27 Member States and that the rules are enforceable.

A Regulation allows for quick implementation (no need for national transposition measures) of fully harmonised measures. This would ensure a level playing field for both consumers and businesses throughout the EU. It also offers a greater potential for private enforcement as Regulations can be directly invoked by business and citizens before national administrations and courts, whereas for Directives this can be done only in very limited circumstances.

A Directive would however also be suitable; there is still a margin of discretion left to Member States to decide the means for achieving the specific results. While a Directive with potentially differing national implementations has the risk of creating market fragmentation, it has the benefits that tailor-made solutions can be designed to address national market specificities. Moreover, Commission guidance or implementing measures may be used to limit variations in implementation. A Directive could also allow for maximum harmonisation in some areas, with minimum harmonisation in others. This would provide for a greater degree of flexibility. It is therefore recommended to use the legal instrument of a Directive for the package of proposed measures.

As stated above, with a Directive, proportionality can be assured by choosing an appropriate degree of harmonisation. Detailed harmonisation is not always necessary or appropriate, as the structure of housing markets and mortgage markets differs throughout the EU and products and remuneration structures also vary. EU intervention needs to be detailed enough to be effective but high level enough to take into account Europe’s diversity. High level principles for advice and remuneration would encourage creditors and intermediaries to consider their processes and ensure that they operate in the clients’ best interests, without unnecessarily restricting how they operate. Disclosure of remuneration structures would further reduce the risk of conflicts of interest influencing the product sold by enhancing transparency and making the borrower aware of the potential risks. There is also the possibility to give technical guidance on certain issues in order to minimise the impact of certain measures being implemented in radically different ways and thus acting as a barrier to the single market. Implementing measures would, where appropriate, be subject to separate public consultations and cost-benefit analysis.

Table 31 shows how proportionality is taken into account through the varying different levels of harmonisation. It also identifies potential areas where implementing measures could be developed to clarify certain aspects. This targeted approach to harmonisation is consistent with other legislation in the field of retail financial services.

Table 31: Proportionality – Minimum or maximum harmonisation

Policy option	Level of harmonisation (minimum, maximum, implementing measures)
Advertising and marketing	
3: Specific rules	In theory, this could be minimum or maximum harmonisation. A high level of harmonisation would however maximise the benefits, and in particular, ensure a degree of comparability. This would also ensure a degree of consistency with the approach taken in the CCD. To take account of developments and to ensure uniform application, implementing measures may be considered.
Pre-contractual Information	
3.2: Specify a deadline for the provision of information	This could only be attained through maximum harmonisation.
4: Improve the format and content of the ESIS	In theory, this could be minimum or maximum harmonisation. However, a high level of harmonisation would facilitate the comparability of information and maximise the benefits for consumers. At the same time, a degree of flexibility is required in order to facilitate the use of the ESIS to be used for the wide range of products that exist.
5.2: Standardisation of the APRC on the basis Article 19 of the CCD	This could only be attained through maximum harmonisation.
6: Additional pre-contractual information	In theory, this could be minimum or maximum harmonisation. A high level of harmonisation would however maximise the benefits, and in particular, to ensure a degree of comparability. However, a lower level of harmonisation may also be more proportionate in order to ensure that different national structures can be accommodated. To take account of developments and to ensure uniform application, implementing measures may however also be considered.

Advice and explanations	
1.2: Requirement to provide adequate explanations (Article 5(6) of CCD)	This would best be attained through a high level of harmonisation. Implementing measures may be considered in the event a legislative instrument is chosen to clarify how this requirement could be fulfilled.
1.3: Principles-based advice standards	This would imply harmonisation at the level of principles. Member States would be free to determine the more specific standards to ensure that the principles are adhered to.
2.2: Principles-based guidance on remuneration policies	This would imply a harmonisation at the level of principles. Member States would be free to determine the more specific standards to ensure that the principles are adhered to. Implementing measures may be considered in order to clarify terms or concepts in the principles-based guidance.
Creditworthiness and suitability	
1.3: Requirement for the creditor to deny the credit in the case of negative creditworthiness assessment	In line with the CCD obliging an assessment of creditworthiness, this policy option would be subject to full harmonisation. Member States would however be free to determine, if necessary, the methodology for assessing creditworthiness. Implementing measures may however also be considered in the event to clarify the elements that could be taken into account when assessing the borrower's creditworthiness.
1.4: Non-discriminatory access to databases for creditors	In line with the CCD, this policy option would be subject to a high level of harmonisation. Member States and/or credit registers would however be free to determine access conditions for all creditors.
1.6: Requirement for the borrower to provide correct information on his/her situation	This would imply harmonisation at the level of principles. Member States would be free to determine the more specific requirements to ensure that the principles are adhered to. Sanctions could be envisaged if incorrect information is provided, however Member States would also be free to determine the level and nature of the sanctions applied.
2.3: Requirement to warn the borrower if the chosen credit product is not suitable to him/her	In line with Option 1.3 on creditworthiness, this would be subject to a high level of harmonisation. Member States would however be free to determine, if necessary, the methodology for assessing suitability. Implementing measures may however be considered in the event to clarify the elements that could be taken into account when assessing the borrower's suitability.
Credit intermediaries	
1.3: Specific requirements for authorisation and registration	In theory, this could be minimum or maximum harmonisation depending on the level of detail contained in the requirements. However, minimum harmonisation would ensure that a minimum level of standards were reached in order for intermediaries to be able to avail of the passport. Commission guidance could also be considered if necessary. Maximum harmonisation would however create a more level playing field and reduce the risk of regulatory arbitrage.
2.2: Principles-based requirements on prudential requirements and supervision	This would imply harmonisation at the level of principles. Member States would be free to determine the specific prudential and supervisory requirements to ensure that the principles are met. For example, the principles may state that indemnity insurance is required, however Member States would be free to specify in more detail the level and scope of indemnity insurance.
1.4: Introduce a passport	This would best be attained through a high level of harmonisation.
Non-credit institutions providing mortgage credit	
1.2: Principles-based requirements on authorisation and registration	This option would imply harmonisation at the level of principles. Member States would be free to determine the specific authorisation and registration requirements to ensure that the principles are adhered to.
2.2: Principles-based requirements on prudential requirements and supervision	This option would imply harmonisation at the level of principles. Member States would be free to determine the specific prudential and supervisory requirements ensure that the principles are adhered to.

7. CONCLUSION

The analysis has led to the conclusion that the preferred option would be an EU Directive on mortgage credit. The Directive would focus on:

- Introducing specific rules on the advertising of mortgage credit.
- Revising the ESIS in terms of content and format along the lines suggested by the consumer testing undertaken in 2009, harmonising the APRC along the lines of the CCD, and introducing a specific deadline for providing the ESIS.
- Introducing an obligation to provide additional pre-contractual information on the actor who offers the mortgage credit.
- Introducing a requirement to provide adequate explanations and high level principles for the provision of advice and remuneration policies.
- Introducing a requirement for the creditor to assess the borrowers' creditworthiness and to deny the credit in the event of a negative assessment as well as a requirement for the creditor and credit intermediary to assess the suitability of the product offered and to warn the borrower if the chosen credit is not suitable.
- Introducing rules to ensure non-discriminatory access to databases for creditors and a requirement for borrowers to provide the correct information on their situation.
- Introducing principles-based rules on the authorisation, registration and supervision of credit intermediaries and NCIs, and a passport for credit intermediaries.

This combination of policy options will minimise consumer detriment, in particular for consumers with low levels of financial literacy or on low incomes, improve customer mobility, facilitate cross-border activity and create a level playing field throughout the EU. For the other policy options, it could not be ensured that the objectives would be achieved in a timely and effective way. Other policy instruments such as self-regulation and/or a Recommendation are likely to be ineffectual in the areas being targeted. Finally, the preferred policy options mix principles-based rules with specific policy options, offering a targeted approach. EU intervention thus complies with the subsidiarity and proportionality principles.

8. EVALUATION AND MONITORING

The proposed Directive would include a provision stating that a review of its appropriateness and effectiveness in meeting the objectives should be carried out. This review should take place a few years after its implementation and include a public consultation. It could examine the similarities and differences between mortgage credit and consumer credit including: the need for a more coordinated approach; whether some of the provisions, for example the registration, authorisation and supervision requirements, also be applied to consumer credit intermediaries; whether there is a need for more detailed advice standards and whether these should also be applied to consumer credit. The review may also survey stakeholders about their experience, in particular reviewing: the administrative burden on Member States; consumer satisfaction with and use of the ESIS; increase in cross-border business by credit intermediaries and creditors; use of the passport by credit intermediaries; development of the NCIs market; impact of measures on access to credit and the availability of credit; and the effectiveness and usefulness of the suitability assessment.