

**"REGULATING MORTGAGE CREDIT, A PRIMER FOR THE EU"**

Centre for European Policy Studies, CEPS  
European Credit Research Institute, ECRI  
Brussels, 23 June 2011

*Antolín Sánchez Presedo MEP,  
ECON Rapporteur  
"Proposal for a Directive on  
Credit Agreements Related to Residential Property"*

Good morning ladies and gentlemen,

I would like to thank Mr. Karel Lannoo, CEPS' CEO for his invitation to participate in the launch event of ECRI's Task Force Report "A New Mortgage Credit Regime in the EU".

First, I would like to start signalling that in October 2010, I was appointed ECON rapporteur for the Parliament's dossier on "measures on responsible lending and borrowing". I am therefore happy to be the ECON draftsman for the Directive on Credit Agreements Related to Residential Property, but I remain convinced that a wider programme to respond to the challenges of over-indebtedness should consider all products, markets and actors in the credit supply chain, analyse macroeconomic aspects related to credit evolution and its limits, structural measures to protect savers and address the problems related to highly leveraged institutions

**WHICH STEPS ARE TO BE TAKEN FOR A GOOD REGULATION?**

I would say there are four: know where we stand, define our objectives, follow a consistent approach and identify our main lines.

**FIRST,**

## **KNOWING THE SITUATION OF MORTGAGE CREDIT MARKETS**

As you know, the mortgage credit agreement is generally the most important and longer financial commitment in the life of families. It's essential for house ownership, whose average rate in the EU is close to 70% and the total value of the market in the EU amounts above 50% of GDP.

Mortgage credit to consumers is characterised by rare cross-border activity, fragmented markets and growing concentration. As average at European level, the five bigger lenders have a market share above 75%.

Analysing the value chain, the price is the sum of the profit margin of the lender, distribution and management costs, funding costs and risk costs. After the crisis, there has been a widening of the spread between credits and deposits. Lenders are generally credit institutions but at least in 5 Member States the "non credit institutions" represent up to 12%. In most countries lenders distribute directly their products, but in some countries -Hungary, Ireland, Netherlands and United Kingdom the indirect distribution is particularly important. According to the European Mortgage Federation, in 2002, 61% of mortgages was funded by deposits, whereas un 17.5% by covered bonds and 10% by securities ("residential mortgage backed securities", RMBS). However, after the crisis, the mortgage credit growth evolved faster than deposits.

While the epicentre of the crisis was placed at the US subprime market, the EU has suffered its impact through our exposure to derivative products (irresponsibly packaged, rated and traded), the worsening of financial conditions and the widening of economic imbalances. This process speeded up the burst of the "housing bubble" in some countries and created tensions in other Member States such as those that had assumed important credit risk in foreign currency.

The underwriting practices were at the core of our problems. The "Mortgage market review" of the FSA, issued last July, recognises that "non income verified mortgages ...gradually become more widely used, with around half of all mortgages applications in 2007 and 2008 being processed without income verification" and that "at the height of the market, almost 33% of all residential mortgages advanced in the UK were sold on an interest-only basis, with around three quarters of these having no specified repayment vehicle".

**SECONDLY, WE MUST  
IDENTIFY THE OBJECTIVE TO BE ACHIEVED**

In the seventy's, the objective was to foster the internal market through the fundamental freedom of movement of services and establishment, in the eighty's the aim was a minimum harmonisation to allow the functioning of the internal market and to liberalise the banking services sector. Since 1999, with the Financial Services Action Plan, the focus is market integration. This continues to be a pending goal.

The White Paper on Mortgage Credit Market (2007) considered that "a further integration of mortgage markets is essential for the European economy as well as for the good functioning of the internal market". Nowadays it is fundamental for accomplishing the strategy EU2020 on sustainable growth and the G-20 commitments for a more resilient and reliable financial market at the service of real economy.

Making progress towards an advanced mortgage market with a high level of consumer protection requires good information, consistent underwriting

practices and symmetric relations between lenders and borrowers. It means fair competition.

Summing up, we must achieve a well oriented market integration by promoting efficiency, competition and stability in the mortgage markets. The core objective is therefore, a sustainable European mortgage market.

### **THE THIRD STEP WOULD BE TO FOLLOW A CONSISTENT APPROACH**

When passing law at European level, we must follow the principles of better regulation ensuring that value is added.

We need to build upon the existing acquis. Some Member States have implemented the Consumer Credit Directive also for mortgage related credits. I think that it is important to keep coherence with the CCD, but also to acknowledge the differences arising from the content and average duration of the agreements.

Diversity at national level is not a problem but an asset. We must preserve models that work adequately and are the result of lasting legal and cultural traditions. There is no case for full harmonisation.

Targeted harmonisation should only be used where needed for the functioning of the internal market. We should therefore ensure a level playing field; where possible only establishing a European ground, according to the subsidiarity and proportionality principles, to leave room for consumer protection and prudential measures at national level.

However, in some cases, in order to ensure efficiency, it may also be necessary to establish ceilings in addition to the common grounds. That is what we could call a "framed harmonisation".

### **LAST, BUT NOT LEAST, THE FOURTH STEP, DEFINING CLEAR HEAD LINES**

I agree with the Turner Review (published in March 2009) that underlined the need to protect consumers' economies from irresponsible indebtedness, safeguard the solvency of the banking system against irresponsible lending and reduce the peaks in the economic cycles. And I also consider that the G20 Conclusions calling for increased transparency and flexibility to serve the needs of families and business must be developed. These are not mere words but ruling guidelines.

An enormous amount of literature and research on the field of mortgages has been developed over the past few years in the European Union and around the world. I have also had access to a lot of papers on the Commission proposal. My view is that, although it can be improved, there is a good acceptance of its content. However, this does not mean that the proposal is enough.

It lacks a wider perspective. I miss, for example, references on financial education, mortgage funding, sound performance of the credit agreement and transparency in the markets. It could be useful to include some provisions on these important topics.

I consider also that a consistent Regulatory reform should take into account two important references: the US Dodd Frank Act (July 2010) and the principles developed by the Financial Stability Board in its thematic review on mortgage

underwriting and origination practices published in March. They are a good source of inspiration to avoid unnecessary penalties on consumers, to deal with data access and to introduce practical criteria.

Equally, I believe that it is necessary to complete the article on definitions. My information on the Council works is that they are going to include a definition on advice. I share this line and consider that it could be extended to some more topics. The most important that I am considering is the definition of "special risk agreement"; it is needed to internalise costs, to introduce more prudential requirements and to protect consumers.

My aim is that the new regulation is coherent with the compromise of the European Parliament on the financial reform by strengthening the prudential dimension and articulating it with the new financial supervisory system. The supervisory authorities where the property is placed must have tools to ensure strong underwriting standards and commensurate powers to act in a layer of intervention.

Another important issue are the delegated acts set up by the proposal, which have been highly commented by several stakeholders. Given the national character of mortgage markets in the European Union, I agree that local authorities have an important role to play. However, when consistent harmonisation is needed at European level to promote an efficient internal market, delegated acts could be used. Moreover, when this harmonisation requires technical expertise from the European Supervisory Authorities, technical standards could be developed.

Ladies, gentlemen,

I seek to improve and complement with my report the Commission's proposal in all the areas I have just mentioned. After the crisis, we can not address this dossier the way we would have done it four years ago. I intend to translate these words into action and hope to count on your support and collaboration in making sure that we establish robust and resilient European mortgage credit markets. I look forward to working with you in the coming months in order to achieve this goal. Thank you very much.