SUBMISSION ON MORTGAGE CREDIT REGULATION IN THE EUROPEAN UNION TO THE DEPARTMENT OF FINANCE

Free Legal Advice Centres, August 2006

1. CONSUMER PROTECTION

1.1 – Information

Our simple view would be that a consumer about to enter into the most significant financial transaction of his or her life should have the maximum amount of information at his or her disposal before the contract is concluded. How mortgage credit is defined is also critical here. We note that the glossary at the back of the Commission's green paper on mortgage credit in the E.U defines 'mortgage backed security' as 'Debt instruments collateralized by residential, commercial or industrial real estate mortgages'. Thus, it would appear that any loan agreement that involves the deposit of the title deeds of real property as security for a loan is covered in the Commission's thinking, including first legal mortgages used to finance the purchase of property, refinancing, equity release and loan consolidation.

In our view, it is critical in any discussion in relation to proposed intervention and regulation of mortgages, that a wide definition of what constitutes a mortgage should be taken[1]. There is a world of difference between a first time buyer with a clean credit rating comparing relatively minor differences in the cost of mortgage credit offered by the high street mortgage lenders and the borrower with a poor credit rating who may be 'asset rich but cash poor' who has to avail of sub-prime lenders (of which there are an increasing number in Ireland) to cope with indebtedness and mortgages a house or lands to do so. Of course, the former is entitled to the widest possible amount of information to make an informed choice in a competitive market but the consequences of choosing one high street mortgage lender over another are likely to be minimal, at least in the short term. On the other hand, the latter transaction is fraught with danger. Not only are the rates likely to be way above industry norms, but default penalties, hidden charges and broker's commissions are but a few of the unpleasant surprises that may lie in store.

In short, the borrower acting in desperation seems to us to be the one most in need of pre-contractual information before it is too late and repossession of the family home or land is threatened. It is noted that the Code of Conduct incorporating the European Standardised Information Sheet (ESIS) has up to now been voluntary and the Commission's paper indicates that an external study found that implementation was not satisfactory. We wonder the extent to which that study revealed differences in practice between high street deposit taking mortgage lenders and non deposit taking sub prime outfits.

[1] See, for example, the Irish Consumer Credit Act 1995 (as amended) which contains such a wide definition of a housing loan

However, we also note that the definition of 'Home Loan' for the purposes of the Code seems to be far narrower than the Commission's definition of 'mortgage backed security' in its paper, referring as it does to *'a credit to a consumer for the purchase or transformation of the private immovable property he owns or aims to acquire'*. This seems to limit the application of the Code to loans to purchase or improve property and would appear to exclude loans where a consumer simply raises cash for any purpose on the strength of a deposit of title deeds, for example to clear debts or to raise cash 'for that cruise of a lifetime'. We believe that it should be clarified with the Commission whether equity release or consolidation products are covered by the voluntary Code at all and whether this issue was examined in the context of its study.

Whilst accepting the Commission's point that *'a careful balance must be found between information deficiency and information overload'*, it is equally important that salient pieces of information that may impact severely on the consumer's ownership of their family home should be included in mandatory pre-contractual disclosure. For example, there is no specific mention at present of default interest rates in the current ESIS. Under Heading 3 – Nominal rate, it is stated that *'where relevant, the description should include details of how the interest rate will vary including, for example, review periods, lock-in periods and related penalty clauses, collars and caps etc.*

To us, this is far from clear and again it should be clarified whether this specifically covers default rates or not. This is surely a matter of considerable potential importance to a consumer who may become unable to afford to meet their instalment obligations under a mortgage agreement. Consumers should be entitled to compare the different default interest rates operated by mortgage lenders prior to entering into a housing loan, rather than discovering these costs (which in some cases can be disproportionate) after the event.

In response to the Commission's questions and those raised in the Department's covering note on the consultation, we submit the following:

- The Code should be binding not voluntary. The decision being made by the consumer is just too vital for pre-contractual information to be an optional exercise
- The definition of housing loan in the Code should include any loan secured by the deposit of title deeds of the principal residence of the borrower
- The information in the ESIS or equivalent should be more extensive and might also include the following additional items:

    1. The default interest rate policy of the mortgage lender concerned
    2. Any other additional fees that will be levied on the borrower in the event of default, for example, administrative charges or the cost of solicitors letters
    3. A statement that the borrower's home may be at risk in the event of a failure to keep up payments, that legal proceedings for repossession of the property may be taken and that the cost of such proceedings may be charged to the borrower

4. Whether mortgage protection insurance on the life of the borrower/s is compulsory and a statement that the borrower may choose their own insurer, where applicable
5. A summary of the relevant rules of the lender in relation to communications with the borrower at home or at work in connection with the agreement or communications with the borrower's family or employer in connection with the agreement
6. A statement that a borrower who is unhappy with the conduct of the agreement (should they ultimately enter into one) may, having exhausted the lender's internal complaints mechanism, make a complaint to the relevant Ombudsman for Financial Services

The Commission considers it necessary to attempt to identify a common E.U stage at which the obligation to provide pre-contractual information will apply '*that enables the consumer to shop around and compare offers'*. It is suggested that this stage might be reached where the consumer makes a specific request in writing on a prescribed form for a quote from the mortgage lender. Although lenders will argue that this adds to their overall costs, it is equally suggested that the colossal profits (certainly in an Irish context) made by mortgage lenders on consumer loans more than offsets the cost of this exercise.

The Commission asks whether the obligation to provide information should apply to brokers (including intermediaries) as well as lenders. Once a broker is specifically acting as an agent for a mortgage lender, it seems illogical to us that the obligation would not apply. Indeed, if it did not, brokers could be used by mortgage lenders to circumvent their obligations under the Code. Finally, the Commission asks how compliance with any such regime can be ensured. It would appear to us that the appropriate regulator of financial services in the Member State could take on an enforcement role here. In the Irish context, the Consumer Protection Code recently adopted by IFSRA would seem to be an ideal vehicle, with the possibility of enforcement action under the administrative sanctions programme being taken where a mortgage lender or broker refuses to carry out its obligations.

Finally, it should be said in passing that in a domestic Irish context, some of the provisions of the Consumer Protection Code are relevant to the question of obligatory pre-contractual information in relation to mortgages (see Chapter 2 of the Code – Common Rules for all regulated entities) and appear to already go beyond the requirements of the ESIS.

1.2 – Advice Provision Framework

The Consumer Protection Code also impinges on this area. We would be a little curious about the use of the word advice here. Assuming that the Commission paper is referring principally to advice from the provider of the mortgage product to the consumer of that product, we think the word advice is a bit disingenuous. In our view, advice to the consumer conjures up notions of objectivity and where the mortgage lender has a vested interest in the outcome; it is arguable that they cannot be entirely objective.

This is tacitly accepted in the Consumer Protection Code by way of obliging regulated entities (subject to some limited exceptions) to conduct a fact find under the heading 'knowing the consumer' and an assessment of 'suitability' of the recommended product for the consumer's needs. These are welcome developments as they at least place some onus on the service provider to take the consumer's interests into account at the point of sale and they are backed up by the Regulator's Administrative Sanctions programme. However, in our view, they are not a substitute for independent objective advice being provided to consumers, especially those in vulnerable financial circumstances.

In the Irish context several agencies play key roles here in terms of community financial education. These include the Regulator itself which has a broad consumer information remit, the Money Advice and Budgeting Service (MABS) which has a specific community education remit (when it is not too busy dealing with the ever increasing amounts of consumer over-indebtedness in Irish society) and other bodies such as Citizens Information Centres (CIC's). In our view, these services need to be complemented by targeted financial literacy programmes aimed at improving the awareness of the benefits and pitfalls of availing of credit products delivered at a local level to consumers. The Commission could have an input into the funding and development of such programmes as part of its overall strategy (encapsulated in the Consumer Credit directive) of enabling consumers to make an informed choice in relation to the consumption of credit.

1.3 – Early repayment

Part V of the Consumer Credit Act 1995, Sections 52 and 53 (transposing Article 8 of Council Directive 87/102/EEC) provide for a right to a rebate in the event of early termination of a credit agreement, whether at the initiative of the lender or the borrower. The responsibility for introducing formulae to calculate the rebate rests with each Member State and the Central Bank is charged with setting such formulae in Ireland. However, despite a decade of the legislation, no such formula has ever been introduced. In practice, many of the finance houses specialising in car finance hire purchase use a formula called the rule of 78ths to calculate the rebate due to the hirer on early termination. In any case, this part of the Act does not apply to housing loans principally because the directive does not.

The Consumer Credit Act does, however, regulate housing loans in a separate part (Part IX) even though the directive does not require it. Section 121 deals with the question of the redemption of housing loans and provides that a borrower will not be liable to pay a redemption fee on a variable rate housing loan. In practice, as we understand it, the mainstream deposit taking mortgage lenders do not seek to charge for future interest when a borrower terminates the agreement early and this may be one of the main reasons why the legislature did not seek to extend Part V of the Act to housing loans. In any case, Section 121 can be argued to preclude a charge for future interest in that it defines a redemption fee in relation to a housing loan as *'any sum in addition to principal and any*

interest due on such principal (without regard to the fact of the redemption of the loan) at the time of the redemption of the whole or part of the loan'.

Nonetheless, returning to the subject of sub prime lenders, there are entities that purport to charge borrowers for future interest where redemption is proposed and who use the Rule of 78ths for this purpose. We believe that it is inappropriate for this rule to be used for loans of a long duration for which it was not designed. It can be argued that the Consumer Credit Act 1995 forbids this in any case. However, we believe that the activities of sub-prime lenders (rates charged, charges for redemption, broker's fees) in the housing loan area should be examined by the Commission, with a view to regulating such mortgages and protecting borrowers from excessive charges.

1.4 – Annual Percentage Rate (APR)

In our view, APR can only be used on the same basis for mortgages as any other credit agreement. APR may only include those costs that the consumer **has** to pay for the credit exclusive of penalties. The most frequent bone of contention here is the question of payment protection insurance (PPI). In relation to non-mortgage personal lending – personal loans, credit cards etc – PPI is always portrayed as optional so it does not have to be included in the calculation of APR. In relation to housing loans, the Irish CCA makes life protection insurance compulsory in the majority of instances. However, the legislation also prohibits the linking of services, so that a lender is not entitled to insist that a borrower avail of ancillary services like insurance from the lender or its agent but may avail of such services on the open market. Thus, the cost of such life cover is not included in the calculation of APR for housing loans in Ireland.

It is difficult to see how the Commission could get around this difficulty short of making such insurance compulsory from the lender and this would be anti-competitive. One suggestion is that a lender be obliged to provide two quotes, one with and one without life cover or other payment protection insurance. This might at least draw the borrower's attention to the cost of such insurance and encourage shopping around.

Finally, a related issue causing concern to us at present is the offering of credit insurance products on a lending basis at a high interest rate. In other words, the PPI is not paid for from the borrower's own funds but forms an additional part of the loan with the PPI prepaid for the duration of the agreement. For example, I borrow €5000 to be repaid with interest over 36 months; I borrow a further €1000 with further interest to cover the cost of PPI at the same rate as the cash I am advanced. Thus, I receive €5000 but am repaying €6000 plus interest. Insult is added to injury when you examine the very high rates of interest charged under such agreements.

Again, we would like to see the Commission and indeed the Financial Regulator in Ireland examining these sub prime lending practices and curbing by specific regulation the worst excesses of them, whether the agreement is a housing loan or a personal credit.

2. CLIENT CREDIT-WORTHINESS

We accept that there is a difficult balance to be struck between a right of access to credit and an obligation to lend (and indeed, borrow, responsibly). We would argue that much of Ireland's economic growth in recent years has been sustained by consumer borrowing and that this comes at a cost in the form of indebtedness. We have argued at length and continue to do so that debt enforcement procedures in Ireland need to be modernised to reflect this reality.[2] However, we are also of the view that more stringent checking of creditworthiness needs to be carried out by lenders in order to establish the borrower's ability to repay. We also believe that if such checks are not carried out, are incomplete or ignore the facts and the borrower subsequently is unable to pay, that's/he should not bear sole responsibility for that default. We also of course accept the fact that many borrowers lie (in some cases encouraged by brokers and even creditors) about their circumstances and that this should also be a relevant consideration in determining responsibility

Given that there is a certain cross border dimension to the provision of credit (perhaps not as much as might have been envisaged); it makes sense that information shared amongst creditors might be accessed on a cross border basis. However, questions as to who has access to this information and how it is kept accurate and up to date are critical. Access should be restricted to bona fide credit providers who should have to obtain a licence according to set criteria. The continuation of the licence should be subject to a condition that the credit provider agrees to update information on agreements that it has handled as soon as it becomes available.

Questions also arise in relation to the knowledge of the data subject that such information is being processed and for what purposes in addition to the giving of informed consent. For example, it is common for an applicant for a loan to give consent to the credit provider to both check his/her credit rating prior to the agreement being concluded and pass on details of how payments are made on the account into the future, with one and the same signature. This signature is often the one that the credit provider requires to apply for the loan in the first place so the consumer has no choice in the matter. This is not informed consent and data processors should have much clearer obligations imposed upon them to ensure that the data subject consents fully.

A right of access to and rectification of inaccurate information is also then essential and the role of data protection agencies in the Member States (such as the Data Protection Commissioner in an Irish context) is vital to protect the interests of the data subject in this respect. Perhaps some thought might be given by the Commission to creating an umbrella data protection office that might specialise in information that is available on a cross border basis.

[2] See Joyce.P – 'An End based on Means' May 2003, Free Legal Advice Centres.