

**GENERAL POSITION FOR THE PARLIAMENT OF THE
CZECH REPUBLIC -
WHITE PAPER ON THE INTEGRATION OF EU
MORTGAGE CREDIT MARKETS**

Ministry of Finance of the Czech Republic – 2008

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I. General position on the White Paper

The Czech Republic welcomes the publication of the White Paper and the processing of the preliminary impact assessment. We consider the impact assessment highly beneficial for determining further steps leading to the strengthening of the competitiveness and effectiveness of the EU mortgage markets. At the same time, we agree with the need to prepare a more detailed impact assessment that will already contain a quantitative cost-benefit analysis of each solution. We would also like to emphasise that the White Paper cannot be deemed a final document, as it identifies further steps that need to be taken to integrate the EU mortgage markets. The aim of this integration should be a more effective and competitive mortgage market contributing to economic growth and facilitating the movement of labour while respecting and protecting consumer interests.

We are not able to assess the conclusions of the studies related to the economic benefits of integrating the EU mortgage markets mentioned in the White Paper. We do, however, agree with the fact that integration of the mortgage markets is limited by factors such as language, distance, consumer preferences, historical practices, or lender business strategies. Most of these factors will continue to exist and, in the opinion of the Czech Republic, will always limit the cross-border provision of mortgages.

II. Position on each of the objectives of the White Paper

We agree with the European Commission's objectives in the White Paper. It is practical to remove the obstacles to the provision of mortgage credit throughout the EU; on the other hand, however, we call attention to the fact that there will always be certain obstacles (see above) that will limit cross-border lending.

Not every national market offers all existing mortgage products. The Czech Republic is a case in point. Removing obstacles to cross-border supply of mortgage credit can help support diversity of supply; nevertheless, as mentioned above, there will always be limiting factors. We are aware of the fact that numerous consumer protection measures and financial stability measures can slow the development of new products. We also agree with the need to examine in more detail the effect of these measures on market development and product diversity.

Providing clear, complete, and comparable information is indubitably one of the prerequisites for integration of the European mortgage market and development of cross-border mortgage lending. As concerns the facilitation of consumer mobility, we agree with the need to remove obstacles preventing consumers from switching mortgage lenders, as mobility has a significant effect on economic competition. At the same time, however, we call attention to the fact that client mobility can result in (sometimes substantial) costs for lenders. These must always be taken into consideration before deciding to adopt new rules.

III. Position on each of the areas addressed by the White Paper

▪ **Early repayment**

The right to early repayment of a mortgage should be **stipulated directly in legal regulations** (by means of a directive or transposing law), with the condition that the **consumer cannot waive this right beforehand**. The legal regulation should thus state that the consumer has the right to early repayment.

We also believe that the right to early repayment without sanctions is a risk for the mortgage lender, as it could lead to an increase in mortgage lending costs. We therefore consider it appropriate if the lender were able to set the specific amount of the penalty (specific amount also mean a percentage of a certain amount) for early repayment. The lender must, however, inform the consumer about this amount in advance – as part of pre-contractual information.

We further propose stipulating in the EU the right to early repayment of the mortgage in its entirety or in part as at the end of the fixed interest rate period, and at no charge.

We therefore agree with the Commission's opinion that **legislative treatment is the best option** for this area. On the other hand, however, we expect a more detailed assessment of the impacts to ascertain whether the benefits of this measure outweigh the costs.

▪ **Improving the quality and comparability of information**

Efficiency, timeliness, and transparency in providing information and the balance and comparability of such information throughout the EU are one of the prerequisites for the integration of the EU mortgage market and the development of cross-border supply of mortgage credit. To attain these objectives, it is necessary to ensure a single application and interpretation of these rules and subsequent supervision over adherence to them. This is, however, only possible by way of a binding regulation adopted in the form of a directive in a maximum harmonisation regime or a decree created using the experience with the functioning of the European Agreement on a Voluntary Code of Conduct on Pre-Contractual Information for Home Loans (the "Code") and the European Standardised Information Sheet (the "ESIS").

Furthermore, the survey performed by the Consumer Defence Association in the Czech Republic in 2007 on adherence of Czech banks to the mortgage code issued on the basis of the Code of Conduct of the Czech Banking Association (the "Mortgage Code") shows that the Mortgage Code does not fulfil its main purpose on the Czech market: provision of clear and for the consumer comprehensible information about mortgage credit. The information obligations contained in the Mortgage Code are breached repeatedly. The excessive generality of the Mortgage Code, its purely recommendatory nature, and the inability to enforce adherence thereto are particularly problematic. A reason for this, among other things, is the fact that the Czech Banking Association (the publisher of the Mortgage Code), is only a voluntary professional association without the ability to issue binding rules and enforce them.

The results of this survey also confirm the need to ensure awareness through binding regulations.

a) Pre-contractual information

This area is key to increasing the transparency of the mortgage credit market. Pre-contractual information should serve to compare offers of similar products of various mortgage lenders and contain information about the risks and implications of failure on the part of the client to fulfil his obligations. Pre-contractual information should also include a standardised glossary of professional terms related to the mortgage credit. The basic criterion is comprehensibility of the information, as we are not dealing with a legal document but basic information about a product.

We recommend providing as much information as possible according to ESIS already during the product comparison phase when researching competing offers, i.e., at the time when the consumer shows interest in obtaining a mortgage. The influx of general information and a certain extent of individualisation of pre-contractual information could be ensured in

particular through remote (on-line) access, to allow the client to compare products to the greatest extent possible already from home instead of as late as at the time of concluding the agreement. If additional information or more individualisation is needed, the information can be provided upon the consumer's request.

The obligation to provide pre-contractual information should be contained in EU legal regulations because, as described above, the voluntary provision of information leads to this obligation not being fulfilled. Thus, we also agree with the EC's position: a legislative solution is the most effective.

b) Annual Percentage Rate of Charge (APRC)

The rules for the calculation method and for cost bases should be stipulated by a binding EU regulation, just as all the other rules for the provision of information should. Setting the APRC rules correctly is one of the prerequisites for achieving integration of the mortgage market.

APRC should contain all charges that are to be paid to the bank by the consumer in connection with arranging a mortgage loan and that can be expressed in financial terms at the time of the information being provided. Unfortunately, this is a problem of long-term products, which mortgage loans are, as it is not possible to calculate beforehand all charges that the consumer will have to pay to the bank during the existence of the credit relationship. Therefore, items paid to the bank that are not included in the base for calculating APRC should be clearly stated and enumerated and their effect on APRC, if any, explained and indicated, for example, in the amortisation table.

For example, calculation of APRC is stipulated directly in the new Consumer Credit Directive, which also provides an exact definition and stipulates the items to be included in the calculation. It would be possible to deal with this problem in a similar way with respect to APRC for mortgages, provided that the uncertain future interest rates and any change in charges in respect of this long-term product are dealt with. This problem is dealt with in respect to consumer loans in Article 19(4) of the Consumer Credit Directive, which states the following: "In the case of credit agreements containing clauses allowing variations in the borrowing rate and, where applicable, charges contained in the annual percentage rate of charge but unquantifiable at the time of calculation, the annual percentage rate of charge shall be calculated on the assumption that the borrowing rate and other charges will remain fixed in relation to the initial level and will remain applicable until the end of the credit agreement." If a similar provision were used with respect to mortgage loans, the question remains how predictable would APRC calculated in this way be. On the Czech market, mortgage loans are almost always provided with a fixed interest rate period that is shorter than the maturity period of the loan. One solution could be an obligation to add a warning to the information about APRC that the calculation stems from the current interest rate, with a future change in the interest rate leading to a different APRC amount.

We, therefore, recommend carrying out a thorough impact assessment of APRC calculated in this way, including comprehensibility and benefit for the consumer.

▪ Promoting responsible lending

Consumers should make sure that they are prudent and responsible when taking on debt by obtaining sufficient information about all conditions of the mortgage loan being considered and becoming financially literate to a sufficient degree. Lenders should then make sure that they have the necessary expertise to be able to provide high quality advice.

a) Knowledge and awareness

Knowledge and awareness should be ensured in particular by providing pre-contractual information in accordance with the Code and ESIS (see above).

b) High quality advice

We differentiate between lending and advisory.

When lending, the consumer should be provided with all required information to a similar extent as ESIS already at the pre-contractual phase – this information should be compulsory (see “pre-contractual information”).

Advisory, on the other hand, is a specific service that can be provided either for a fee as a separate service or for free, with it being desirable that this advice be of high quality, independent, complete, and transparent. We reject compulsory advisory, however. We assume that the problem of high quality and independent advice will be dealt with by the EC horizontally, but we do not support making advisory compulsory.

c) Improving financial literacy

Just as the EC does, we consider financial literacy one of the tools, not the only one, to protect consumers. Adequate financial literacy, which is necessary for the consumer to make a responsible decision, is absolutely necessary for products of a long-term nature, such as mortgage loans.

Education in the financial market is dealt with in the Communication on Financial Education published alongside the White Paper. For this reason, we do not deal with this issue further.

▪ Property valuation for mortgage purposes

The issue of securing mortgage loans properly can have significant influence not only on cross-border activity, but also on the stability of the banking system. It is in particular necessary to ensure that neither over-valuation nor under-valuation of the price of property occurs.

We support adoption of a single EU standard setting out the principles for valuating property for mortgage purposes that would greatly simplify recognition of expert valuations from abroad, thus contributing to the integration of the mortgage markets. These principles (standards) would be determined in the form of an EC Recommendation to the Member States, which is in accordance with the EC’s opinion. Valuation performed according to the standards would then be recognised within the EU. It is necessary to verify beforehand, however, whether lenders are willing to recognise these valuations.

We, therefore, consider as sufficient the option assessed by the impact assessment to be the most effective (EC Recommendation).

▪ Land registers

Improving the rules governing land registers is another prerequisite to the integration of the mortgage markets. From the cross-border perspective, it is necessary to ensure their legal certainty, credibility, currency, and transparency. Any disputes and other legal steps leading to property ownership rights listed in the land register being challenged should be recorded in the land register as soon as possible after they arise, and the institutions dealing with such

actions or ruling on them should be obliged to report them to the land registers (this means mainly the courts, notaries, distrainers, bankruptcy administrators and the like).

Of course, easy remote (on-line) access to this information should also be ensured. At the national level of the Czech Republic, remote (on-line) access to data in the land register is already in use by banks and other institutions and is fully functional. Even in terms of user charges, this system is cheaper than if the extract from the land register were picked up in person. We are not aware of any hidden charges.

We agree with the ongoing promotion of the EULIS (European Land Information Service) project, in which the Czech Republic should be taking part. The recovery value of European investment into such systems should be ensured in particular through the differentiation of charges for use of these multinational access points. We would like to reiterate that this project will only be successful if all of the EU Member States take part in it.

We are bearing in mind the EC's challenge to ensure greater transparency and reliability of the land registers. At this time, entries into the Czech land register (the "land register") are made according to the formal publicity principle. According to this principle, the land register is publicly accessible and anyone can view it and obtain copies or extracts. The current legal regulations also recognise that persons acting based on land registry entries (only those made after 1 January 1993, however) do so in good faith, which can be one of the conditions for acquiring ownership through usucaption. Effective protection of the acquirer of the property or other tenure is provided only by the material publicity principle, which appears to be at best a suitable addition to formal publicity. According to this principle, he who relied on the entry in the land register when acquiring property or other tenure is protected even if the state of the facts did not correspond to reality. The current legal regulation, which was necessary at the time of its implementation and a logical result of the state of the land registry entries when it came into existence on 1 January 1993, can no longer be considered entirely appropriate. The draft of the new Commercial Code should, however, introduce good faith protections in terms of the state of the rights recorded in public registers established on the material publicity principle. According to this principle, it will be possible for everyone under certain conditions to refer to the records in public registries (to which the land register belongs). We therefore recommend that this issue not be dealt with legislatively at the European level, instead leaving it to the competence of the Member States.

- **Foreclosure procedures**

Concerns that in some cases foreclosures will be long, non-transparent and uncertain are an obstacle to integration of the mortgage markets. We agree with the EC's approach (publishing "scoreboards" and recommendations) as achieving significant harmonisation through binding EU regulations in this area is not realistic and it is up to the Member State to ensure that foreclosure procedures end by reasonable deadlines and at reasonable cost.

- **Role of non-credit institutions on the EU mortgage credit markets and "equity release" products (financing products and reverse mortgages)**

We welcome further studies in these two areas in 2007, the results of which will show what the next steps should be.

- **Tying and other unfair practices**

We support the EC's intention to investigate tying and other unfair practices even with respect to mortgage credit. These practices restrict consumer mobility and can be an obstacle to cross-border provision of mortgage loans.

- **Interest rate restrictions**

We do not agree with setting an interest rate cap. A high-risk category of clients exists, and a higher interest rate must be used for such clients. An interest rate cap could lead to higher risk products being restricted or precluded, and thus the disappearance of a market for such products. Despite their high risk, these products are necessary on the market. A higher risk rate is reflected in a higher interest rate; therefore, we do not agree with implementing an interest rate cap.

We consider the Czech home loan market to be sufficiently competitive to allow interest rates to be created based on market mechanisms.

We believe that the issue of interest rates is sufficiently dealt with at the national level, be it through legal regulations or established court practice. We however welcome the EC's efforts to carry out more studies on this issue.