

---

# **A new Mortgage Credit Regime for Europe**

## **Final report presentation**

Center of European Policy Studies  
– Brussels, June 23 2011

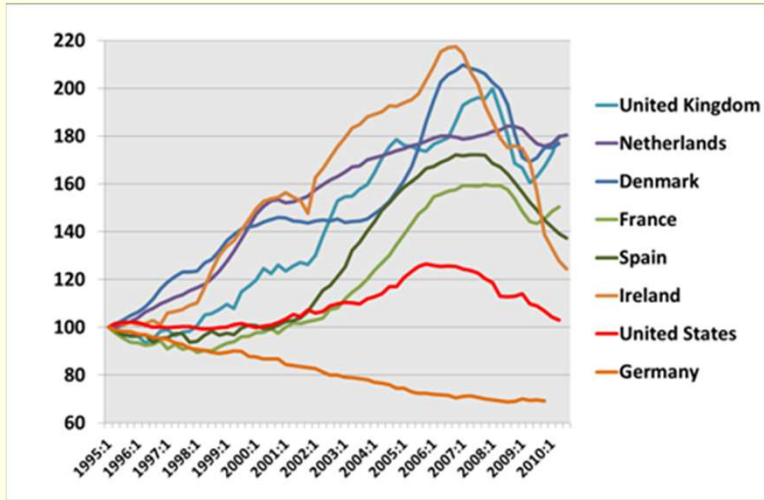
Hans-Joachim Dübel  
[Finpolconsult.de](http://Finpolconsult.de), Berlin

---

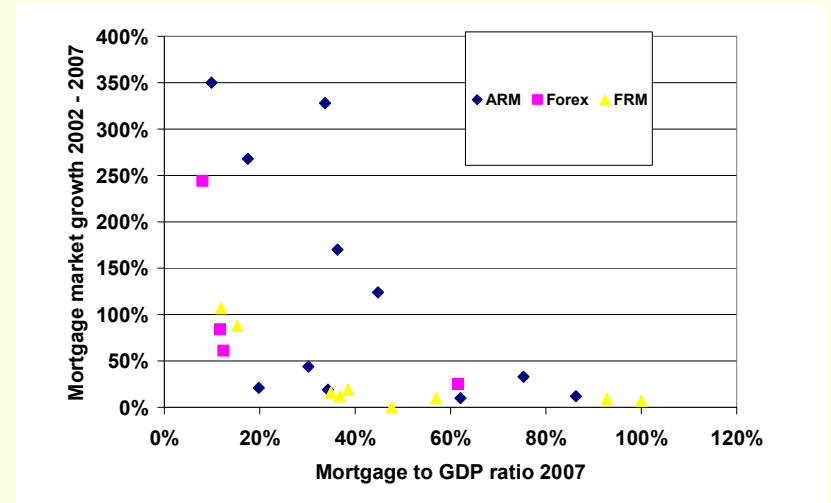
## Mortgage market risk drivers – United States and Europe

Risk driver	United States	Europe
Macro	Current account deficit, low national savings. Global borrowing privilege	Current account deficits, low national savings. Intra-Eurozone borrowing privilege.
Capital market	International sales of MBS/CDO, agency bonds; disintermediation & investment bk arbitrage.	International sales of MBS, private covered bonds; bank intermediation did not pre-empt crises.
Mortgage market		
- House price valuation	Open market, fixed rate as implicit discount factor	Open market, adjustable rate (lower, more volatile) as implicit discount factor in most markets.
- Mortgage products	Dichotomy: callable FRM for Prime, ARM & teaser for Subprime and with rising price level near-Prime / 'Alt-A' (payment shock risk).	Dominance of ARM & Forex (payment shock risk), % rising with price levels, ARM caps only in FRM-dominated markets, non-callable FRM (roll-over risk)
- Other underwriting	High LTV as public policy priority (public/private mortgage insurance). Low-documentation % rising with price levels. Credit intermediaries and servicers arbitraging funding exits.	LTVs rising with price levels (IRE, UK), partly tax-driven high-LTV lending (NL, DK). UK LTV declining after 90s. Low-documentation % rising with price levels. Limited role of credit intermediaries / servicers.
- Market penetration / retail vs. corporate	Large Subprime sector, no significant corporate housing finance (rental).	No or small Subprime, however lending to young/immigrants (no rental housing) and 'Alt-A' (affordable for Prime only in conjunction with ARM); only core / North with strong corporate (rental) housing.
- Foreclosure / consumer insolvency	Fast discharge in most states. Extra-judicial foreclosure dysfunctional in crisis.	Mixed discharge picture, but high barriers in crisis countries (ES, IRE). Foreclosure politically pre-empted.

## Inflation: house-price to income ratios Europe and United States, 1995 - 2010



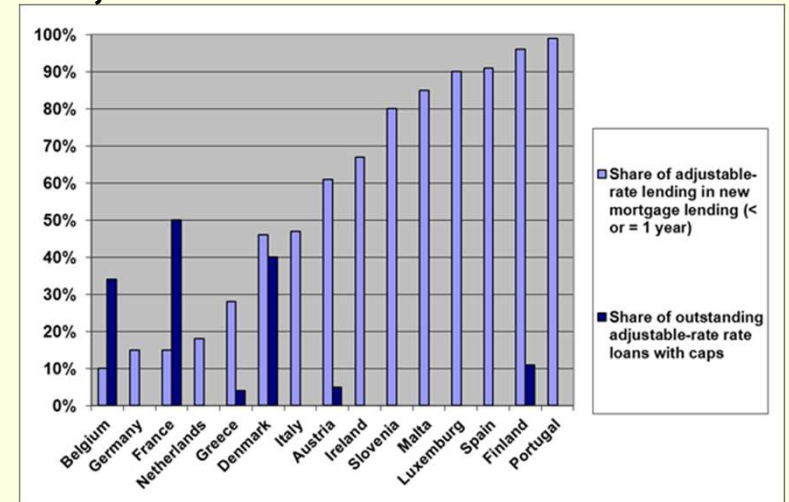
## Predominant products & market growth: EU-27 2002 - 2007



## Credit risk: share of low-income and young households with a mortgage in Europe, ca 2005-2007

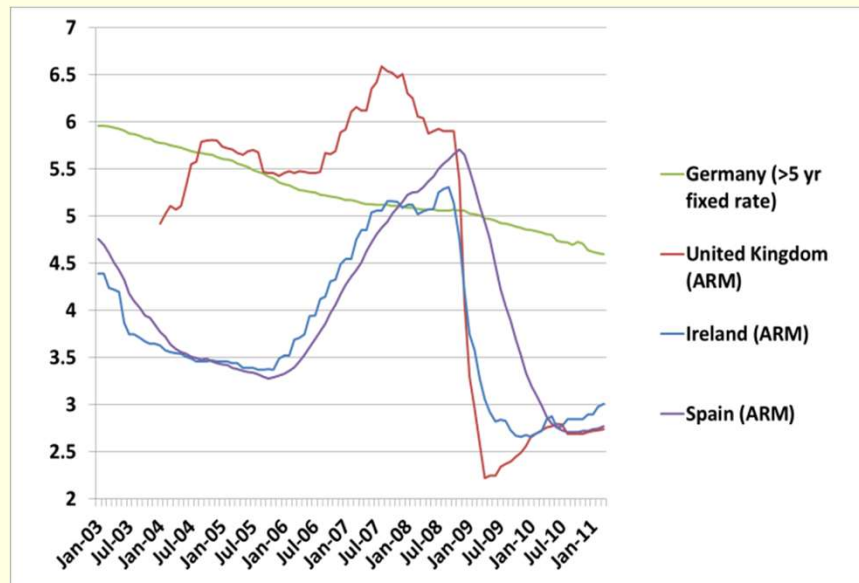
	Share of households with a mortgage	Share of households in the lowest income quartiles with a mortgage	Share of households (head < 35 years) with a mortgage
Germany	27	7	16
<b>Ireland</b>	<b>36</b>	<b>7</b>	<b>49</b>
Greece	17	4	12
Spain	25	8	46
France	30	na	35
Italy	12	4	14
Netherlands	39	23	25
Portugal	30	6	53
United States	45	na	na
United Kingdom	40	na	na

## Interest rate risk: share of ARM and ARM with caps in Eurozone, ca 2007



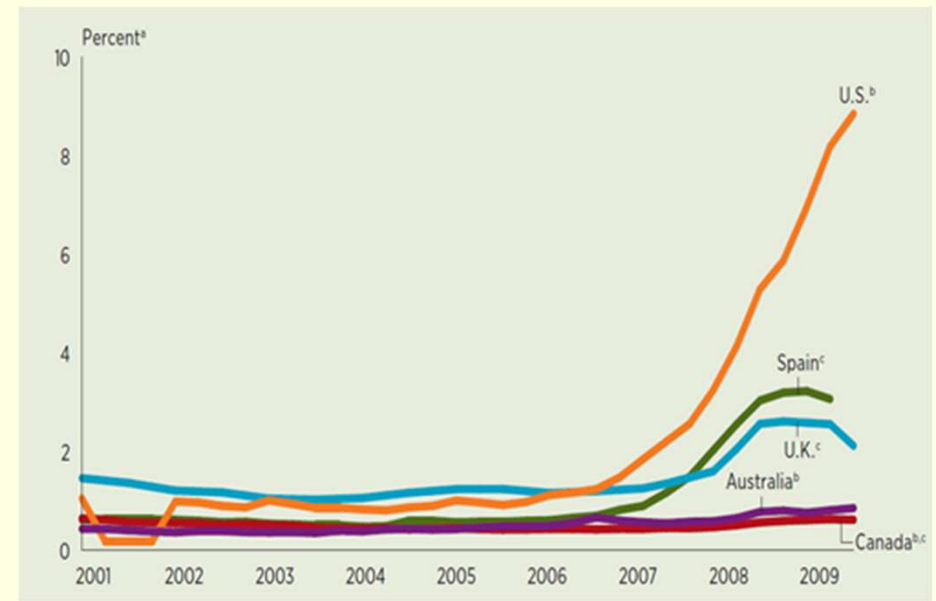
# Have the combined consumer / bank bailout policies within the EU created amnesia regarding mortgage reforms?

**Interest rates on outstanding loans in the dominant national mortgage portfolios in four European countries, 2003 – 2010**



**U.S. median interest rate 2010 ca 5.75%.**

**Mortgage default rates, 2001 – 2009**



## Mortgage market crisis management & regulation efforts

Policy option	United States	Europe
Central bank policies	'Unsuccessful' Fed bailout as credit crunch pre-empts prepayments; lender recapitalization is priority.	'Successful' ECB/BoE bailout as ARM react directly to rates; yet conceals structural consumer insolvency (inability to pay normal rates).
Fiscal policies	FHA refinancing of private Subprime. Restructuring programs HAMP/HARP. GSE/mortgage tax deduction reform (?) Fed buys/repos w Treasury guaranty.	ECB credit easing (private ABS repo, covered bond purchases). ESFS backs nationalization of bank debt. National write-down policies/bank recaps.
Legislation, general	Dodd-Frank, interagency guidances.	Proposed EU Directive, EBA rules pending (?).
Legislation, transparency	Single-page information sheet (plan).	ESIS and APRC mandatory.
Legislation, underwriting	Qualified residential mortgage (LTV limits); specific responsible lending rules (fully-index/amortizing).	Responsible lending rules in proposed EU Directive. Wide national discretion range (ex. Forex, from ban, HU, to stress-testing, PL).
Legislation, products	ARM caps mandatory. Prepayment penalties on high-rate loans outlawed.	UK: non-conforming ban (?), forex bans in AT and HU. Suitability criteria via EU Directive (?).
Legislation, funding	Basel III (leverage ratio), skin in the game f. MBS, covered bond law	CRD (leverage ratio unclear), skin in the game f. MBS
Foreclosure prevention	De-facto foreclosure moratoria and restructurings.	De-facto foreclosure moratoria and restructurings (IRE, LAT, HU).
Institution-building	Consumer Financial Protection Bureau	None (in consumer protection)

## Mortgage Credit Regime (Consumer Protection) for Europe

Issue	Proposed Directive	Proposal
Pre-contractual information / credit intermediaries	Standard advertisement info & ESIS. Intermediary authorization, registration, supervision, professional requirements.	In addition: specific cooling-off period; tripartite ESIS development. <i>Comment: excessive focus of Directive on intermediaries only laterally problematic in EU.</i>
APRC	Broad APRC (CCD definition) mandatory	Both narrow and broad (cost of credit) APRC for national / international comparison; combined product APRC; realistic maturity and adjustable-rate assumptions.
Creditworthiness assessment	Appropriate processes, data and borrower information access. Duty to credit denial.	In addition: mandatory stress-testing, based on the specific product, amortization and loan-to-value offered.
Advice	Minimum standards, no requirement for banks or credit intermediaries.	Labeling of independent credit intermediaries (advisors). Financial education program.
House price valuation	Not in Directive.	House price valuation standard (discounted cash flow).
Loan to value rules	Not in Directive; CRD mortgage definition.	See stress testing requirement.
Amortization rules	Not in Directive.	See stress testing requirement.
Products, general	Suitability in conjunction with credit assessment, criteria delegated to KOM. No action on Forex.	See stress testing, standardizations below and delegations.
Early repayment (FRM)	Early repayment right subject to conditions. Member State discretion on indemnities.	Universal early repayment right. Standardization of indemnities (non-callable FRM).
Rate adjustment (ARM)	Not in Directive.	Mandatory caps (but NOT mandatory indexation, 1988 CCD), including for Forex (form of ARM).
Non-regulated areas / delegations	5 year review of post-contractual stage regulation need. Limited number of delegations.	Interaction process between Member State and KOM analogous to State Aid re more far-reaching rules. Missing : e.g. loan assignment, linked contracts (developer/bank), foreclosure and consumer insolvency.