

10th of February 2015

Final EMF Comments on EBA Consultation Paper on Draft Guidelines on Product Oversight & Governance Arrangements for Retail Banking Products

The European Mortgage Federation¹ (EMF) welcomes the opportunity to comment on the EBA's draft Guidelines on product oversight and governance. The EMF wholly subscribes to the objective of protecting consumers from detriment and improving confidence in retail financial markets and the integrity of the financial system in general.

With this in mind, the EMF would like to recall the significant body of existing retail financial services legislation, both at national and EU level, which appropriately and adequately protects consumers. The Mortgage Credit Directive (MCD), as an example of recently adopted EU legislation, provides for extensive requirements relating to conduct of business, knowledge and competence, pre-contractual information, explanation to consumers, and credit intermediaries. Very similar content can be found in other Directives and Regulations that have been recently approved on different banking and financial products (such as the Payment Accounts Directive, MiFID II, Consumer Credit Directive, etc.). All of these pieces of legislation have specific provisions based on the typology of the product and their complexity. For example, linked to this point, the MCD does not provide scope for the elaboration of regulatory or technical standards for mortgage-specific product oversight and governance requirements. However, the draft guidelines approach different banking and financial product as a whole, without considering as relevant the different features and complexity of the products. It would be of paramount importance for the EMF therefore to understand the reflections that the EBA considered for these draft guidelines.

Remaining on the same subject, the EMF would like to respond to the examples of consumer detriment in the area of mortgage credit provided in the rationale section of the consultation document. In relation to the example of mortgages sold in conjunction with other products, the EMF would like to recall that the MCD addresses concerns regarding cross-selling by providing for a ban on tying, with certain important exemptions. Bundling is permitted. As far as the foreign currency mortgage example is concerned, again here the MCD provides for extensive disclosure requirements and risk minimisation provisions.

The EMF believes that consideration should be given generally to the timing of and timetable for these guidelines. Regarding the former, the EMF believes that the EBA should wait to observe the impact of the MCD, which will not be fully transposed and implemented until March 2016, before introducing more rules. Regarding the latter, the timetable is challenging. National authorities have 12 months to implement these guidelines. That will require consultation with credit institutions, which, given the current transposition and implementation of the MCD, will be difficult.

General Questions

Question 3: Are there any additional requirements that you would suggest adding to either of the two sets of requirements? If so, why?

¹Established in 1967, the European Mortgage Federation ([EMF](#)) is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The volume of outstanding mortgage loans in the EU amounted to €6.7 trillion at the end of 2013. As of November 2014, the EMF has 20 members across 15 EU Member States as well as a number of observer members in the EU and the Russian Federation. The European Mortgage Federation - European Covered Bond Council (EMF-ECBC) is registered in the European Institutions' Transparency Register under ID Number 24967486965-09.

As a general remark, the EMF would like to recall that according to the EBA Consumer Trends Report 2014, in order to help consumers to make informed choices, it would be more useful to develop at national level, together with national authorities and consumer organisations, financial literacy programmes targeted at different kinds of consumers, than to develop product oversight and governance arrangements for retail banking products.

The Mortgage Industry is very concerned about the discretion accorded to competent authorities “to expand the scope of consumers by also including other persons, such as micro-enterprises or intermediaries other than credit intermediaries”². This provision undermines the establishment of a clear and stable regulatory framework for financial institutions. It furthermore does not take into account the fact that products for micro-enterprises are often ‘tailor-made’ for each enterprise, negating the need for to define a ‘target market’, and that the relationship between financial institutions and enterprises is not comparable to the relationship between financial institutions and consumers.

Specific questions regarding Guidelines for manufacturers (Title II)

Question 4: Do you agree with Guideline 1 on establishment, proportionality, review and documentation?

The EMF would like to point out that, in its impact assessment, the EBA does not assess the impact of guidelines of this kind on the ability of financial institutions to produce new products and services, and therefore the knock-on effect for the mortgage business and the economy more generally. The Mortgage Industry is concerned that these guidelines would constrain credit institutions’ activities in relation to the production of new products and services and thereby limit product variety which generates positive externalities for the whole economy by way of price differentiation and greater competition. In fact, there is a risk that small credit institutions could be regulated out of the market. Moreover, the cost-benefit analysis does not consider the aggregate impact of financial regulation on foregone innovation, which these guidelines will increase further. We will comment on innovation later in this response.

Question 5: Do you agree with Guideline 2 on manufacturers’ internal control functions?

Product design processes are already part of credit institutions’ internal control processes at national level. In addition, compliance departments are responsible for identifying potential conflicts of interest within the product development process, and therefore an additional formalised process is not necessary. In fact, some of the requirements could in fact have a negative impact on product innovation, by slowing down the process and adversely affecting competition in the market.

Question 6: Do you agree with Guideline 3 on the target market?

As a general remark, while the Mortgage Industry does not question the rationale behind the identification of target markets, it strongly believes that a distinction should be made in any such discussions between complex investment products on the one hand, for which the identification of a target market is vital, and mainstream, well-established retail financial services and products such as mortgages (and consumer credit products and payment services), on the other, where adequate pre-contractual information and explanation is more appropriate as reflected in the Mortgage Credit Directive (MCD) (and the Consumer Credit Directive (CCD)).

²EBA Consultation on Draft Guidelines on on Product Oversight & Governance Arrangements for Retail Banking Products, page 10.

The guidelines require manufacturers and distributors to create or distribute products which meet the interests, objectives and characteristics of the particular target market identified for each of these products. This goes beyond the scope of the MCD and in particular article 7 which requires creditors and credit intermediaries to take account of the rights and interests of consumers. In fact, the requirement on lenders to ensure that a product is appropriate for the interests, objectives and characteristics of the identified target markets for mortgage credit potentially introduces a kind of suitability assessment of a given product, something which was purposely rejected during the legislative process in the context of the MCD further to extensive discussions and negotiations within and between the EU Institutions.

One of the primary concerns about the introduction of a suitability assessment is the shift of responsibility from the borrower to the lender³, which would result in increased lender liability and a greater risk of litigation. For example, the Industry is very concerned about the potential for a consumer in default to bring a case against a lender using his default as proof of the granting of an 'unsuitable' product (see below). Furthermore, it is never clear exactly how far lenders' responsibility extends, meaning that this would most likely be determined during judicial proceedings in national courts. This requirement could produce the unintended consequence of limiting the offer of mortgages to certain categories of consumers e.g. first-time buyers, young professionals, self-employed individuals, and would therefore appear to be contrary to the EBA's aim of ensuring good consumer outcomes and re-establishing and maintaining confidence in retail banks.

It is for these reasons that the MCD (and the CCD) requires lenders to provide information and explanation to consumers on the different mortgage products available in their ranges in order for the consumer to decide which product is best suited to his or her needs.

Looking at the draft guidelines in relation to target market specifically, the EMF would like to make the following comments:

▪ **Guidelines 3.2 and 3.5:**

- These guidelines would require lenders to effectively deny a request for a specific product from a consumer outside of the product's target market. This would be difficult to justify for a consumer with a positive creditworthiness assessment who has been provided with adequate information and explanation. This presents a risk of exclusion or discrimination which is potentially of more concern than the risk of the mortgage loan itself. It is in fact contrary to the aims of the MCD and CCD, which, as suggested above, put the emphasis on the provision of adequate information and explanation to the consumer to enable him/her to decide which product best suits his/her needs.
- On the flip side, and linked to the point about liability and litigation risk outlined above, a lender may be convinced that it has targeted the 'right' product to the 'right' market, but, in the event of consumer default, the consumer may claim that this was not the case. The burden of proof would then be on the lender to demonstrate the contrary, in other words creating a situation of "probatio diabolica".
- Furthermore, in the design process regarding new, innovative products, it is not always possible to respond to explicit consumer objectives because, by definition, innovative content seeks to pre-empt consumer needs which at that time might not be apparent.

³ To recall, the fact that it is the borrower's responsibility to take the final decision as to which loan best suits his needs is an important principle which was agreed upon with consumer representatives during the negotiation of the Voluntary European Code of Conduct on Home Loans in 1999 and confirmed by the Commission in the 2007 White Paper on Mortgage Credit.

- **Guideline 3.4:** It should be borne in mind that the potential constraining of the offer of products on the market in this way would have the effect of reducing competition.
- **Guideline 3.6:** This guideline implies that the market is characterised by the presence of standardised groups of people. In reality, every market is made up of different individuals with different financial capabilities and financial means/assets. The EMF questions what the value is of the assessment of average financial capability of a target market compared to a full creditworthiness assessment carried out for each individual candidate borrower, based on his/her individual circumstances when applying for a mortgage loan.

Question 7: Do you agree with Guideline 4 on product testing?

Product testing is habitually carried out by credit institutions before bringing products to market. Credit institutions would be unlikely to survive if they created products that consumers do not want. Making product testing a systematic requirement on lenders regardless of the type of product would not only increase costs, but also unnecessarily extend the time to market of products. Further, the methodology may only be as effective as the last product tested. Having to update it to take account of lessons learned the last time a product was tested may delay even more the time it takes to get a new product to market. This would impact on a credit institutions' ability to secure the advantage over other credit institutions, thereby impeding innovation.

Question 8: Do you agree with Guideline 5 on product monitoring?

- The Industry does not oppose the principle of product monitoring per se - in fact this is a typical part of ongoing relationships with consumers - but insists that such monitoring should be on the basis that the product continues to meet the interests of consumers generally, and not a target market.
- As an additional point here, the draft guideline is vague in relation to the frequency with which this monitoring should be carried out, referring only to that fact that it should be carried out "on an ongoing basis". Any requirement in relation to the frequency of product monitoring should be proportionate.

Question 9: Do you agree with Guideline 6 on remedial action?

- Remedial measures could only refer to market failures in general and not to individual borrowers. In the event of a product failure, national and European supervisory authorities would in any case intervene.
- The EMF would also like to point out that reputational impacts are already effective deterrents, as are shareholder interests.
- Finally, borrowers can always resort to out-of-court resolution mechanisms to address problems.

Question 10: Do you agree with Guideline 7 on the selection of distribution channels?

- As a general remark, it is imperative that distribution channels are left to manufacturers.
- On the draft guideline specifically, for mortgage credit, distributors are typically the commercial teams of the lender itself or credit intermediaries. The systematic reference to target market would create complexity in the process with credit intermediaries, especially the reference in point 7.2 to products only being "sold outside the target market on a justified and exceptional basis". The EMF would like to recall that the MCD contains extensive provisions relating to credit intermediaries and it is our assessment that these draft guidelines add additional requirements, which is not appropriate.

Specific questions regarding Guidelines for distributors (Title III)

Question 12: Do you agree with Guideline 1 on establishment, proportionality, review and documentation?

Over and above the problematic references to target market, it is the Industry's view that additional requirements on distribution should not be introduced for credit institutions that are already subject to national and European supervision.

Question 13: Do you agree with Guideline 2 on the distributor's internal control functions?

As for question 12.

Question 14: Do you agree with Guideline 3 on the knowledge of the target market?

The potential problems outlined elsewhere in the EMF's comments in relation to the concept of a target market will be, in our view, exacerbated for distributors/credit intermediaries. To recall the important principle underpinning the MCD, the final decision as to which product best suits the candidate borrowers' needs should be left to him/her, further to him receiving adequate information during the loan application process to enable him to make a well-informed choice.

Question 15: Do you agree with Guideline 4 on information?

With the exception of the reference to target market, the EMF views this as a logical requirement which actually is already the case in credit institution-credit intermediary relationships. These information requirements are arguably not necessary for credit institutions handling both the manufacture and distribution of products.
