The Mortgage Credit Directive: an Overview

Overview

The Mortgage Credit Directive (‘MCD’) (also known as the Residential Mortgage Directive) was proposed by the European Commission on 31 March 2011, but at the time of writing has yet to be adopted into law.

The MCD will move the regulation of mortgage loans onto a similar framework, and with similar provisions as, the Consumer Credit Directive (‘CCD’). It will also introduce mortgage-specific consumer protection laws where the sector was previously covered only by general consumer protection regulation.

The focus of the MCD is on residential property lending, although it expressly invites Member States to extend its provisions to (some) commercial transactions.

Its broad scope – mortgages, “comparable securit[ies]”, credit agreements secured by “right[s] related to residential immovable property”; agreements to purchase, and even some home improvement loans – covers both first and second charges on a property. This would be a major change to the current UK regime, where first charges are at present regulated under the FCA regime, and second charges by the OFT and Consumer Credit Act. It will also certainly complicate the FCA’s Mortgage Market Review.

Following the FSA’s concern about regulation of “niche products”, Member States have been given the power to exclude various products from the MCD, including bridging loans, buy-to-let mortgages, government lending, and credit union lending.

Main Provisions

- **Required information.** ‘Personalised information’ will now have to be provided on a European Standardised Information Sheet (‘ESIS’) with precisely specified form and content. The MCD clearly ignores the FSA’s warning that “too much information can risk overloading the consumer and distracting them from the important messages”.

- **Rules on ‘advice’**. A creditor or intermediary must explicitly say whether or not they are offering ‘advice’ and, if so, whether they are considering only a single lender’s products, or products from the whole market. An intermediary offering ‘independent advice’ can only receive commission from a creditor if they have taken into account “a majority of the market” when making a recommendation. Creditors and tied intermediaries will be allowed to consider only credit agreements from “among their product range”, rather than having to consider the market as a whole (as originally drafted).

- **Requirement to provide ‘adequate explanations’ to consumers.**

- **Authorisation, registration and supervision of credit intermediaries.** As a prerequisite of authorisation, credit intermediaries must hold professional indemnity insurance and meet certain standards for professional knowledge and “good repute”. In return, they will be able to operate throughout the EU on an MCD ‘passport’.

- **Authorisation, registration and supervision of creditors that are not (MiFID) credit institutions.**

- **Obligation to assess creditworthiness.** Creditors will not be able to lend money to consumers unless they have first assessed whether they are capable of meeting their obligations. Credit may no longer be offered only because the value of the security exceeds that of the debt (or might do so in future).

- **Consumer’s right to make early repayment – full or partial – of a mortgage loan.**

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1 Officially, the Directive of the European Parliament and of the Council on credit agreements relating to residential property.
2 Directive 2008/48/EC

UK - 76563468.5
Implementation

As a Directive, the MCD will need to be transposed into national law before it can take legal effect. Typically the deadline for doing so is two years after the Directive is published in the EU Official Journal.

Based on the transposition of the Consumer Credit Directive into UK law (via amendments to the Consumer Credit Act), and the proposed transfer of general consumer credit regulation from the OFT to the FCA, the changes introduced by the MCD will probably involve additions to the FCA rulebook.

The MCD grants national regulators some flexibility in how they implement its provisions; for the most part, it specifies only minimum standards, and expressly allows regulators to ‘gold-plate’ its requirements. Two aspects of the MCD are ‘maximum harmonising’, however, and must be implemented by national regulators without divergence: the calculation of APR (which is the same as under the Consumer Credit Directive) and the requirement to provide consumers with an ESIS with precisely specified form and content.

According to a note published by the Presidency of the Council of the EU on 6 May 2013 “provisional agreement” has now been reached between the European Parliament and Council on all but a single Article of the MCD, and it is expected that full agreement will eventually follow. A final vote of the European Parliament is currently scheduled for 9 September 2013.

Firms do not need to begin doing anything in response to the MCD yet, but it appears that major changes to the sector in future are now almost inevitable.

Introduction

Background

The European Commission had previously published a Green Paper (in 2005) and a White Paper (in 2007) looking at how to move towards a single market for mortgage services. The two main precursors of the MCD are:

- the 2001 European Voluntary Code of Conduct (‘EVCC’) on pre-contractual information for home loans, which also introduced the first ESIS; as a voluntary code, implementation of the EVCC was “inconsistent and sub-optimal”; yet the pre-contractual disclosure obligations in the MCD “largely mirror the voluntary obligations set out in the [EVCC]” although the ESIS has been updated (see below); and
- the CCD, which does not expressly apply to secured loans such as mortgages, but which some Member States have chosen to apply nevertheless; the MCD “complements the [CCD] by creating a similar framework”, and the MCD also “largely draws on the conduct of business provisions in the [CCD].”

Objectives

1. Financial Stability. Although the Commission acknowledges that certain harmful lending practices have declined since 2008, “it is essential that a robust regulatory framework is in place to ensure that the mistakes of the past are not repeated”, especially “[w]hen markets and the economy pick up further”. The Commission also notes that other financial legislation, e.g. the Capital Requirements Directive, will encourage more sustainable lending practices.

The Financial Stability objective is apparent in the obligations to assess the creditworthiness of a borrower; requirement for authorisation, registration and supervision of non-credit institution mortgage lenders; and – particularly relevant to Eastern Europe – the ability of a borrower to change a mortgage from one currency into another.

2. Completing the internal market. The original impetus for the Commission’s work on the mortgage market pre-2008 was the concern that the “single market for residential mortgages is far from completion as several obstacles exist to the free provision of services”. In practice, the Commission acknowledges that the mortgage market is very local – “only a small fraction of the European population is active cross-border” – and that integration in practice will mean assisting creditors from one Member States to offer their products via local brokers and firms. The diversity of the housing and mortgage markets across the EU has also dictated the form of the legislation: a (relatively) flexible Directive that will allow national regulators to ‘gold-plate’ its provisions where desired.

The internal market objective is apparent in the requirement for standardised pre-contractual information (the ESIS); the establishment of a passport regime for credit intermediaries, and the requirement for non-discriminatory access to credit databases.

3. Consumer protection. Although some previous consumer protection regulations did apply to mortgage credit, they did not specifically address the mortgage market or its particular features and concerns.

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3 European Commission, Explanatory Memorandum to the MCD.
4 Ibid.
5 European Commission, ‘Creating a fair single market for mortgage credit – FAQ’.
6 Ibid.
7 Ibid.
Scope

The MCD applies to:

- credit agreements secured by a mortgage (or similar\(^8\)) on residential immovable property;
- credit agreements to acquire or retail property rights in land or in an existing or projected building;
- some credit agreements aimed at financing the renovation of a property;
- buy-to-let mortgages*;
- bridging loans*;
- lending by credit unions*;
- loan secured against residential property “the purpose of which is not to acquire or retain the right to residential immovable property” (e.g. business loans, etc)*; and
- government lending, i.e. loans “granted to a restricted public under a statutory provision with a general interest purpose”, either interest-free or at below-market rates*.

*Although the MCD expressly gives national regulators the power to exclude these from the scope of the Directive.

The MCD itself expressly excludes:

- equity release schemes;
- interest- and charge-free loans;
- overdrafts that have to be repaid within one month;
- credit agreements that are the outcome of a court settlement (or similar);
- where an employer extends interest-free (or below-market rate) credit to his employees as a secondary activity, and where he does not offer the same to the general public; and
- credit agreements which relate to the deferred payment, free of charge, of an existing debt.

Importantly, the Commission’s Explanatory Memorandum observes that the MCD “does not preclude the possibility that some Member States may wish to extend the scope to other beneficiaries such as small or medium-sized enterprises or indeed to some commercial property transactions.”

Conduct, Supervision and Authorisation

Conduct of business requirements (Art 5-6)

Creditors and credit intermediaries must act “honestly, fairly, transparently and professionally, taking account of the rights and interests of the consumers”, basing their actions on “information about the consumer’s circumstances and any specific requirement made known by a consumer and on reasonable assumptions about risks to the consumer’s situation.”

Remuneration policies should not cause any conflicts with the above; in particular, staff remuneration should not be contingent on sales targets. Member States are given the power to ban commissions paid from a creditor to a credit intermediary.

Staff of creditors and credit intermediaries must “possess and to keep up-to-date an appropriate level of knowledge and competence” related to their work. Member States “shall establish minimum knowledge and competence [...] requirements” for them.

Authorisation, registration and supervision of credit intermediaries (Art 19-22)

Credit intermediaries must be officially authorised or registered by a competent authority (i.e. a national regulator). Once they are registered or authorised, they then may ‘passport’ and operate in any Member State.

In order to obtain authorisation/registration, credit intermediaries must:

- hold professional indemnity insurance (or similar) for the countries in which they provide services; tied intermediaries may be allowed to rely on their tied creditor’s insurance; and the European Commission and European Banking Authority may later specify minimum levels of insurance coverage;
- be of good repute, including all members of the board (or equivalent); “good repute” means, at the very least, having a clean police record “in relation to serious criminal offences linked to crimes against property or other crimes related to financial activities” and not being an undischarged bankrupt; and

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\(^8\) Including e.g. a second, or equitable mortgage.
• “possess the appropriate level of knowledge and competence” (which level will be defined by the Member States; see above); this requirement also applies personally to members of the board (or equivalent).

These requirements must be complied with on a continuing basis. Credit intermediaries will be primarily supervised by their home Member State regulators – but, where they are operating in another Member State, the host Member State regulator also has some powers of supervision and enforcement over them.

A public register will be kept of all authorised and/or registered credit intermediaries. This will include, among other things, details of whether the intermediary is tied to a particular creditor or not.

An authorised credit intermediary may appoint Appointed Representatives.

The requirements may be waived for regulated professional firms providing credit intermediation on an incidental basis to their main professional activities.

**Authorisation, registration and supervision of non-credit institutions (Art 23)**

No detailed rules are laid down here: Member States are simply required to ensure that non-credit institutions are “subject to adequate admission process”, recorded in a register, and thereafter supervised by a regulator.

**Advertising, Information and Disclosure**

**Principles for advertising and marketing (Art 7-8)**

In general, advertising and marketing must be “fair, clear and not misleading”. [...] In particular, wording that may create false expectations for a consumer regarding the availability or the cost of a credit shall be prohibited.”

Any advertising which features an interest rate or other cost of credit figure must include certain ‘standard information’ as follows:

- the identity of the creditor, intermediary or Appointed Representative;
- that the loan would be a secured by a mortgage (etc.);
- the borrowing rate (including whether it is fixed or variable) and charges;
- the total amount of credit;
- APR “at least as prominently as any other interest rate” (and on the calculation of the APR figure, see below);
- duration of the credit agreement*;
- amount of any instalments*;
- number of instalments*;
- total amount payable*;
- a warning that fluctuations in the exchange rate could affect the amount payable (i.e. for loans in a foreign currency)*; and
- any obligation to enter into an ancillary service (e.g. a contract of insurance), the cost of which cannot be determined in advance, in order to obtain credit at the advertised rates*.

(*Where applicable.)

All information should be “easily legible or clearly audible”, and all figures should include a representative example.

Member States may also require the inclusion of “concise and proportionate” warnings concerning specific risks.

**Pre-contractual information (Art 9-10, 11, 17)**

(a) General Information

Creditors, intermediaries and Appointed Representatives must provide “clear and comprehensible general information”, which will include at least:

- the identity and address of the issuer of the information;
- the purposes for which the credit may be used;
- the forms of the security (including the possibility for it to be located in a different Member State);

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9 Defined as “any creditor that is not a credit institution”; i.e. a non-bank
10 Member States have the power to exclude this requirement from advertisements that only contain a (legally mandated) APR figure but no other interest rate or cost-of-credit information.
- the possible duration of the credit agreement;
- the types of available borrowing rate – fixed, variable, or both – and what they mean;
- whether credit is available in a foreign currency (and the implications of a foreign currency loan);
- a representative example of the total amount of credit, cost of credit, total amount payable and APR;
- any further costs to be paid;
- repayment instalment options;
- where applicable, a “clear and concise statement” that credit agreements do not guarantee repayment of the total amount of credit;
- conditions related to early repayment;
- whether a property valuation is required and, if so, whose responsibility it is;
- whether the consumer is also required to purchase any ancillary services (e.g. insurance) and, if so, whether they can purchase them from someone other than the creditor’s preferred supplier;
- a general warning about what the consequences of not complying with the terms of the credit agreement; and
- any other warnings that a Member State might require.

A creditor or credit intermediary must also tell the consumer explicitly whether they are offering “advice services” in relation to a given transaction or not. If so, then before they give the advice they must inform the consumer in writing whether they are going to consider a wide range of products, or only a single lender’s product range. They must also say (where applicable) what the fee for the advice will be; or at least how the fee will be calculated.

Credit intermediaries, “in good time” before providing any services, must provide consumers with the following information:
- the intermediary’s identity and address;
- the capacity in which any Appointed Representative is acting, and for whom they are acting*;
- the register in which the intermediary is registered; their registration number; and how this might be verified;
- whether they are tied to (or work exclusively for) one or more creditors and, if so, the identity of the creditor(s);
- whether they offer advisory services;
- their fee, or at least how their fee will be calculated*; where the intermediary receives both a fee and a commission (see below), they must also say whether the commission will be offset against the fee;
- the complaints and redress procedures open to consumers; and
- whether they are paid commissions or inducements by the creditor (or another) in relation to the credit agreement; and, if so, how much*. (If this is not known it must be provided later via the ESIS.) Consumers should also be informed that can request information on the variation in the level of commission offered to the intermediary by different creditors.

(*Where applicable.)

(b) Personalised Information

Creditors, intermediaries and Appointed Representatives must also provide personalised information for consumers, which will allow them to compare the different credit options available to them, assess their implications, and make an informed decision.

This must be provided “without undue delay” after the consumer has provided them with the necessary information, and “in good time” before the consumer is bound by any credit agreement.

The information must be provided in the European Standardised Information Sheet (‘ESIS’) format, which is laid out in detail in Annex II to the MCD. (This is an updated version of the old EVCC ESIS, designed to help consumers compare different loans.)

The requirement to provide the ESIS, as well as the form of the document, is one of the few ‘maximum harmonising’ parts of the Directive: Member States must use it, without amendment. If they want creditors or intermediaries to provide additional information to consumers over and above this, it must be provided in a separate document annexed to the ESIS.

Member States may require an ESIS to be given to the consumer before an offer of credit is made to him. At the very least, an ESIS must be given at the same time as the offer of credit is made. In either case, where the terms of the credit offered differ from those on an ESIS previously provided, the consumer must be given an updated ESIS reflecting the final terms of the credit agreement.
The consumer must be given a cooling-off period of at least seven days. Member States will decide whether this should take the form of a ‘reflection period’ before signing the contract (in which case the offer will remain binding on the creditor for that period); or a right of withdrawal after signing the contract (in which case, that right of withdrawal replaces the one from the Financial Distance Marketing Directive); or a combination of the two.

The interest rate and/or other costs of credit may differ from the offer given where these are determined by the sale of underlying bonds (or other long-term financial instruments).

If there is no right of withdrawal, the creditor or intermediary must provide the consumer with a copy of the draft credit agreement; if there is a right of withdrawal, they must at least offer to provide the consumer with a copy.

Following conclusion of the credit agreement, creditors must keep consumers informed of any changes in the borrowing rate before that change enters into force. At the same time they should also inform them of the total amount of the payments to be made at the new rate, as well as any changes to the number or frequency of repayments.

This notification need only be made periodically when the changes to the repayment rate are the result of changes in a publicly-available reference rate (e.g. the Bank rate), or else where periodic notifications were permitted under national law before the MCD.

All information specified by the MCD must be given to the consumer free of charge.

(c) Adequate Explanations

Creditors and intermediaries must provide consumers with ‘adequate explanations’ of the credit agreement and any ancillary services. These should allow the consumer to assess whether these are “adapted to his needs and financial situation”.

In particular, they should explain:

- all the pre-contractual information listed above;
- the “essential characteristics” of the proposed products;
- the “effects they may have” on the consumer – especially the consequences of defaulting on payment;
- whether any contracts for ancillary services can be terminated separately, and the implications of doing so.

APR (Art 12)

The definition of APR (or ‘APRC’) and the method of calculation are the same as that under the Consumer Credit Directive.

The precise method of calculating the APR figure is explained in Annex I to the MCD.

This is the only other ‘maximum harmonising’ Article of the Directive, which Member States must implement without any divergence from the Directive allowed.

Obligation to Assess Creditworthiness

Article 14 requires a creditor to make a “thorough assessment” of a consumer’s creditworthiness before concluding a credit agreement with them, which should “take appropriate account of factors relevant” to whether or not the consumer will be able to meet his obligations under the agreement. The creditor can only extend credit to a consumer where the assessment indicates that these obligations are “likely to be met in the manner required under that agreement”.

Member States will establish the procedures on which the assessment will be based.

Creditors must tell consumers “in a clear and straightforward way” the evidence and information that the consumer needs to provide them with. The request for information should be “proportionate and limited to what is necessary” to conduct the assessment.

The MCD advises that the assessment “shall not rely predominantly” on the value of the secured property exceeding the amount of credit – and certainly not on the assumption that the property will increase in value. (An exception to this is credit agreements to build or renovate residential property.)

Once a credit agreement has been concluded, the creditor cannot alter or cancel the agreement on the ground that the creditworthiness assessment is subsequently found to have been “incorrectly conducted” or incomplete – unless the consumer “knowingly withheld or falsified” information.

The creditor must inform the consumer that they intend to look them up on a credit database.
If a consumer fails the assessment, they must be informed of this “without delay”, and also whether the decision was “based on automated processing of data” or following consultation. The consumer should also be told which credit database was consulted.

A consumer’s creditworthiness should also be reassessed before the creditor grants any “significant increase” in the amount of credit extended to the consumer after the conclusion of the original credit agreement (unless this had been foreseen at the time of the original agreement, and included in the original creditworthiness assessment).

Article 15 introduces the corresponding “disclosure obligation on the part of the consumer.”

Member States should have “measures in place to ensure that consumers are aware of the need to provide correct information” in order to carry out the creditworthiness assessment. Creditors and intermediaries should warn consumers that they are not able to grant the consumer credit without receiving the necessary evidence or information they require.

Article 16 ensures non-discriminatory access to databases of consumer credit information by creditors in each Member State. This applies to both private and public credit reference databases.

Other Provisions

Tying and Bundling (Art 9)

‘Bundling’ – where consumers have the option to purchase multiple products together – is permitted under the MCD, but ‘tying’ – where consumers have no option but to buy multiple products – is (generally) forbidden. Member States can allow tying in certain circumstances, however; notably where it will “result in a clear benefit to the consumers”.

Creditors can also (if Member States choose to allow it) require borrowers to open a payment or savings account, buy an investment or pension product, or enter into a separate credit agreement in conjunction with a shared-equity agreement, in order to accumulate capital or provide additional security for the debt. They may also require borrowers to take out insurance for the mortgage – as long as they also accept insurance with an equivalent level of guarantee from a non-preferred supplier.

Advice standards (Art 17)

(See also above on necessary pre-contractual information before advice can be given.)

Advisory services can only be provided by creditors, credit intermediaries, and their Appointed Representatives: Member States can extend this to regulated insolvency practitioners, non-profit debt advisory services, and other regulated professionals (where advice is given incidentally in the course of their professional services).

A creditor (or credit intermediary) giving advice must “act in the best interests of the consumer by informing themselves about the consumer’s needs and circumstances,” first obtaining up-to-date information regarding “the consumer’s personal and financial situation, his preferences and objectives”. They must also “take into account reasonable assumptions as to risks to the consumer’s situation over the term of the proposed credit agreement”.

Next, they should “consider a sufficiently large number of credit agreements” in their product range (for creditors and tied credit intermediaries) or generally on the market (non-tied credit intermediaries) in order to recommend one or more credit agreements that are “suitable” for the consumer. Finally, they should give the consumer a record “in a durable medium” of their advice.

Member States may prohibit the use of the terms “advice” and “advisor” in relation to a creditor or tied credit intermediary. If not, then Member States must impose conditions on the use of the term “independent advice”: for example, an independent advisor who takes into account “less than a majority of the market” when making a recommendation may not receive any commission from a creditor.

Early repayment (Art 18)

Consumers have a new, express right to “to discharge fully or partially his obligations under a credit agreement prior to the expiry of that agreement”, following which “the consumer shall be entitled to a reduction in the total cost of the credit … consisting of the interest and the costs for the remaining duration of the contract”.

Member States may impose limitations and conditions on this right, however; including providing a creditor with “fair and objective compensation” which “shall not exceed the financial loss of the creditor” and cannot include a penalty.

Where a consumer enquires about early repayment, the creditor must provide them “without delay” the “information necessary to consider that option”; in particular, the creditor must calculate the various figures involved.

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11 European Commission, Explanatory Memorandum to the MCD.
Foreign Currency Loans (Art 17a)

Where a consumer holds a loan denominated in a foreign currency, they should have the right (under specified conditions) to convert the credit agreement into either their home Member State’s currency, or else the currency in which they receive most of their income or hold most of their assets. Alternatively, there should be other arrangements in place to limit their exposure to currency risk under the credit agreement.

A creditor must warn a consumer holding a foreign currency loan “on a regular basis in a durable medium” of the dangers thereof; and at least where either the value of the loan amount outstanding or of the regular instalments is more than 20% greater than what it would have been if the exchange rate was still the same as it had been at the time of contracting. This should also inform the consumer of their right to change the currency of the loan as above.

Creditors must also put additional warnings about foreign currency loans into pre-contractual information (see above) and into the credit agreement itself.

Dispute resolution (Art 25)

Creditors are to be encouraged to “exercise reasonable forbearance” before commencing repossession or foreclosure proceedings.

To this end the MCD requires that “appropriate and effective” complaints and redress procedures are established for the out-of-court settlement of consumer disputes, “using existing bodies where appropriate”.

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