



The Consumer Voice in Europe

EBA Consultation Draft Guidelines on creditworthiness assessment under the Mortgage Credit Directive

BEUC RESPONSE

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Background

The Mortgage Credit Directive adopted last year requires that, before concluding a credit agreement, the creditor makes a thorough assessment of the consumer's creditworthiness and takes into appropriate account factors relevant to verifying the ability of the consumer to meet his/her obligations under the credit agreement.

The EBA draft guidelines are aimed at ensuring Competent Authorities implement the MCD consistently across the EU, by providing greater detail on how creditors should give effect to the relevant MCD provisions.

General Comments

BEUC welcomes the opportunity to comment on the EBA Consultation Paper 2014/42 "Draft Guidelines on creditworthiness assessment".

The borrowers' creditworthiness refers to the borrower's financial capacity to repay a loan without creating financial hardship throughout the term of the credit contract.

The objective pursued by the borrower's creditworthiness assessment should be the prevention of over-indebtedness. In case of payment default, the credit institution should take responsibility if its decision is based on a poor quality assessment of the consumer's financial situation (e.g. Belgian law). The costs of irresponsible lending in these circumstances should be borne by creditors and not by consumers.

BEUC generally supports the draft version of the Guidelines, but considers they leave too much latitude to creditors. Creditworthiness assessment should be standardised as much as possible, which means that the guidelines should be more detailed to limit creditors' margin of maneuver. This is the reason why BEUC considers useful to make some comments and proposals which are detailed below.

Replies to Questions

Question 1: Do you agree with the proposed Guidelines? If not, outline why you disagree and how the Guidelines could be improved. Please respond separately for each of the seven Guidelines.

BEUC generally agrees with the proposed guidelines, but has some comments, proposals and remarks which could contribute to a better form and substance of those guidelines. Please see our answer to Question 2.

Question 2: Are there any additional requirements that you would suggest adding to the Guidelines? If so, outline the reason(s) for each proposed additional requirement.

Title II- Requirements regarding creditworthiness assessment

1. Verification of the consumer's income

1.1 The creditor should make reasonable enquiries and take reasonable steps to verify a consumer's prospect to meet his/her obligation under the credit agreement including the consumer's underlying income capacity, the consumer's income history and any variability over time.

1.2 The creditor should use necessary, sufficient and proportionate information, that can be evidenced and that is provided by sources that are independent of the consumer.

1.3 In the case of consumers that are self-employed or have seasonal or other irregular income, the creditor should make reasonable enquiries and take reasonable steps to verify additional information that is related to the consumer's ability to meet his/her obligations under the credit agreement, including profit capacity and third party verification documenting such income.

BEUC supports the above requirements, but considers they need to be more detailed and go further.

BEUC considers that all creditors should be obliged to engage with borrowers and ask appropriate questions in order to evaluate their level of income and request the necessary supportive documents issued by reliable external sources (for example: salary sheets, bank statements, income tax returns of the past years, certificates from social security on the labour history of the borrower, work contracts) and any other extra documentation which they may deem necessary to verify the borrower's income. In any case 'Low doc' or 'No doc' loans should be prohibited.

Assessment of the capacity to repay should always and mainly focus on borrowers' incomes. Except pensions and child benefits, including revenues such as government or social support payments is not a good idea when such revenues are temporary and never guaranteed – conditions of their allocation can change over time.

2. Documentation and retention of information

2.1 The creditor should maintain complete documentation of the information that leads to mortgage approval, and maintain this documentation for at least the duration of the credit agreement.

2.2 The creditor should ensure that a record with an adequate explanation of the steps taken to verify income is readily available for competent authorities. The record should at least document the income history collected for each applicant.

BEUC fully supports these requirements, but the record should also include all the criteria and considerations used by the creditor in making their decision. Considering that granting of credit is not always transparent (e.g.: borrowers who accept to take out additional financial contracts are more likely to have their loan application granted), this requirement should also give the opportunity to the competent authorities to check whether the creditworthiness assessment has been based on principles of responsible lending.

3. Identification and prevention of misrepresented information

3.1 To reliably carry out creditworthiness assessments, the creditor should design loan documentation in a way that helps to identify and to prevent misrepresentation of information by the consumer, the creditor, or a credit intermediary.

BEUC considers that in any circumstance a loan application should not be only based on a questionnaire, but be always based on reliable and external sources of information, which would avoid misrepresented information.

4. Assessment of the consumer's ability to meet his/her obligations under the credit agreement

4.1 The creditor should assess the consumer's ability to meet his/her obligations under the credit agreement without causing the consumer undue hardship and over-indebtedness, while taking into account data protection rules that may apply in the relevant jurisdiction.

4.2 The creditor should establish sound processes to assess the consumer's ability to meet obligations under the credit agreement; review these processes at regular intervals; and maintain up-to-date records of those procedures.

4.3 The creditor should take into account relevant factors that could influence the ability of the consumer to meet obligations under the credit agreement without inducing undue hardship and over-indebtedness. The factors may include other servicing obligations, their interest rates, and the outstanding principal on such debt; evidence of delinquency; as well as directly relevant taxes and insurance.

4.4 If the loan term extends past normal retirement age, the creditor should take appropriate account of the adequacy of the consumer's likely income and ability to continue to meet obligations under the credit agreement in retirement.

4.5 The creditor should ensure that the consumer's ability to meet obligations under the credit agreement is not based on the expected significant increase of the consumer's income unless the documentation provides sufficient evidence.

BEUC supports the above requirements which need to be completed.

As mentioned above, creditors should favour direct contact with borrowers by asking relevant questions and request necessary documents in order to assess their professional and financial situation and their financial objectives.

Loan-to-income and debt-to-income ratios are of primary importance in that respect and should be universally used by lenders and intermediaries. Acceptable levels of these ratios should be defined at national level, by national authorities, in accordance with national specificities, economic indicators and costs of living. As an average, consumer organisations consider that periodic instalments of the loans (principal and interests) for a consumer should not exceed 33% of his monthly net income, which is of common practice in some countries like France and Belgium.

In addition, in the Member States where loan-to-value ratios are used, we believe that consumers should not be lent more than 100% of the value of the property they are intending to buy.

BEUC strongly supports the fact that loan-to-value (LTV) ratio should never substitute for loan-to-income ratio for thorough assessment of a borrower's repayment capacity. Indeed, a low LTV ratio does not mean the borrower will be able to repay the loan. Therefore, loan-to-income is more important, while LTV ratio may serve as a complementary tool. In addition, assessment of creditworthiness should not rely on prospects of house price increase.

BEUC considers that in order to avoid excessive or disproportional use of personal data and comply with Article 20 stating that the “request for information shall be proportionate and limited to what is necessary to conduct a proper creditworthiness assessment”, the proportionality of the use of data used to assess creditworthiness has to be subject in each Member State to the approval of representatives from financial institutions, data protection authorities and consumer/civil society representatives, and fully complies with the EU rules on personal data protection.

Furthermore, we believe that should be clearly defined some criteria for what can be considered invitation to irresponsible borrowing, thereby making it possible to be able to blame the credit institutions when such limits are exceeded and even so the credit is granted.

5. Allowance for the consumer’s committed and other non-discretionary expenditures

5.1 When assessing the consumer’s ability to meet obligations under the credit agreement, the creditor should make reasonable allowances for committed and other non-discretionary expenditures, such as the consumer’s actual obligations, including appropriate substantiation and consideration of the living expenses of the consumer.

BEUC supports the above requirements. In order to better identify the consumer’s actual obligations, in particular those related to recurrent contracts, the creditor should ask the consumer to provide 3 monthly bank statements.

6. Allowance for potential future negative scenarios

6.1 When assessing the consumer’s ability to meet obligations under the credit agreement, the creditor should make prudent allowances for potential negative scenarios in the future, including for example, a reduced income in retirement; an increase in benchmark interest rates in the case of variable rate mortgages; negative amortisation; balloon payments, or deferred payments of principal or interest.

BEUC supports the above requirements.

7. Identification of groups of loans with higher risk profiles

7.1 The creditor should identify groups of loans with a higher risk profile, and should take this into account when assessing consumers’ creditworthiness.

BEUC is not in principle opposed to this requirement which is particularly relevant in some Member States where consumers are proposed more risky loans. However we are concerned that the identification of risk groups of loans may create a discriminatory treatment on the basis of criteria whose definition should not be entirely left to the credit institutions. Furthermore, this information to should be upgradeable and always be updated in order to prevent discrimination.

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