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**MORTGAGES IN EUROPE :**  
**A PRACTICAL APPROACH OF CROSS-BORDER BUSINESS**

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It is actually the right time to assess the situation of mortgage lending in Europe.

As everybody knows the European Commission has been carrying out a thorough analysis of the opportunity to intervene in this area through :

- Forum group experts' recommendations
- London Economics' report on "the costs and benefits of integration of EU mortgage markets".
- Its green paper opening a public consultation until November.

In fact, the main question is dual :

- is there a business case for mortgage cross-border lending in Europe ?
- if so, how the European framework could foster its development ?

I would like to deal with these two topics from a concrete standpoint based on BNP Paribas practical experience.

**1. Is there a business case ?**

The two parties involved in mortgages, lenders and borrowers, already cross the borders and are expected to do so more and more in the future.

But the context is clearly different depending whether we talk about European borrowers or European lenders.

1.1. European borrowers

A scenario in which consumers look abroad for a loan with a view to financing their main home does not exist at a significant scale (some border inhabitants).

In reality at the present time, people take out a loan in a foreign country as the consequence of the purchase of a property in this country (for holiday, retirement or as an investment). In that field two markets are growing today.

#### Northerners going South

This market has significantly increased since 2000.

- In France purchases by foreigners (British, German, Dutch ...) represent today 10 % of the second-hand housing market. A significant part of them take out a loan from a French bank.
- More generally, 15 million of Northern European households are expected to buy a home in the south of Europe over the next ten years.

#### Westerners going East

This second case is more prospective.

It concerns new European Eastern countries' property markets which are cheap and likely to grow. Both western investors and natives living in Western Europe are interested in purchasing properties in these countries.

For the moment they are mainly funded by their home country banks, but in the future they could subscribe loans from local banks.

Some banks have set up special sales networks and products to adapt their supply to these kinds of demand. This effort of adaptation is in general more important when banks plan to sell mortgage products abroad.

### 1.2. European lenders

Our experience proves that when a financial provider enters a market proposing new and attractive products at a competitive price, this can be successful.

Different legal frameworks can be used. But practice shows that whatever the legal framework, economic and organizational questions are the same.

#### The different legal frameworks

- Free provision of services is rarely used, and only temporarily to test a market. At the present time mortgage is considered as too complex a product to be sold on a pure distance relationship without any local contacts.

A physical presence in host countries is necessary at least for distribution, administration of defaults of payment and repossession.

- Lenders operate under the following forms :
  - through branches (freedom of establishment without legal personality)
  - by setting up subsidiaries (legally considered as local banks)
  - by taking over local banks.

The same constraints

- The objective is to benefit from economics of scale stemming from the amortization of costs on a greater number of products sold.

This appears to be the right way to increase profitability and competitiveness allowing to offer lower interest rates.

- The prerequisite for reaching this objective is to limit as much as possible the adaptation of products and processes to local circumstances (national regulations etc ...).

In fact, today, lenders systematically apply the consumers' law (in particular to create consumer confidence).

- How can we proceed ?

Retail banking is based on an industrial organization. Therefore, the mean of achieving economies of scale is to concentrate as many elements of value chain at European level as possible.

For example the use of the same IT system in Europe would allow a common design of products and would provide the same tools of loans' management.

This can be implemented either through a unique data processing platform integrating national specificities in the workflow or by duplicating locally the same IT system.

The cost of a common IT system and finally of mortgage markets' integration will depend on the required degree of adaptation to local circumstances.

That is exactly where Europe can improve the situation.

## 2. How Europe can foster the cross-border business

Europe should reduce non justified national discrepancies and remove a series of obstacles to streamline free establishment in Member States. That would apply not only to consumer protection rules but also to many issues identified in practice.

### 2.1. Consumer protection regulations

It is obvious that significant differences between national consumer protection regulations make cross-border business more difficult.

The legal fragmentation of national markets entails costly adaptations of products and processes while creating risks of distortion of competition.

Harmonisation is definitely the best way to tackle this issue.

But not just any kind of harmonisation. A suitable harmonisation should comply with two features relating to its degree and its scope.

- **The degree** : harmonisation should be full, i.e. prohibiting the existence of any different national rules as far as harmonised areas are concerned.

This is a key condition to achieve concentration of systems and processes at European level.

It does not mean that full harmonisation should be brought into alignment with the most stringent national rules. Harmonisation must target a level playing field addressing both needs of consumers and those of financial providers.

- **The scope** : harmonisation should be targeted, i.e. applying only to items deemed important for integration : in particular information requirements (see the voluntary code of conduct), APRC, early repayment, legal caps on interest rates.

A well designed full targeted harmonisation would not lead to a standardisation of products, but rather leave room for innovation and variety of products.

### 2.2. Other issues

A quite long list of difficulties a mortgage a lender faces when entering a new market has been identified. Some of them can be mentioned :

- Access to credit risk databases : access to national databases by foreign lenders is not always offered on the same conditions as the access offered to domestic lenders.
- Definition of "credit institution" : it is not the same in all Member States, leading to difficulties and uncertainties in implementation of the European passport.

- Property appraisals : valuation methods and the qualification of appraisers are not the same in all Member States.
- Tax aspects : differences exist in treatment between branches and subsidiaries changing these into the latter proving difficult in some countries.

The system of deducting interest tax at the source is inefficient in the case of cross-border credit.

- Funding : this is also a key element for establishing an integrated mortgage market. In particular, the pooling of mortgages based in different countries should be fostered in order to develop a liquid and dynamic secondary market in Europe.

### **In conclusion**

Much work is yet to be done. But it is worth it for at least two reasons :

- existing cross-border activities have mostly proved to be successful,
- European integration of retail banking, among which mortgage credit is a strategic product, is a key element for the growth and the strengthening of banks in Europe. Indeed, European markets must become their domestic market.

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