

## EPFSF Briefing: Mortgage Funding

### Summary.

- Secondary Mortgage markets are becoming increasingly important for mortgage origination in the EU as wider funding opportunities lead to increasing efficiency, product diversity and fostering competition.
- In order to further address specific barriers to the mortgage credit market, the European Commission had set up a Mortgage Funding Expert Group, whose report, published in December 2006, forms an important input into the forthcoming White Paper on Mortgages, due at the end of 2007.

### Background

Mortgage loans outstanding at the end of 2006 are at €5.8 trillion or 50% of the EU's GDP, having more than doubled in the last 10 years. Greater integration of EU mortgage markets could improve the competition, completeness and efficiency of national mortgage markets, impacting on consumer demand and the general economy via household spending. Lenders would realise economies of scale and opportunities for diversification which might result in greater choice and lower interest rates for consumers.

In March 2003, the European Commission launched a review of the market for home loans through the formation of the Mortgage Credit Forum Group, tasked to assess the obstacles to integration of European Mortgage markets. The 48 recommendations of the Forum Group Report, presented in December 2004, addressed consumer confidence, legal issues, collateral issues, distribution issues, and finance and formed the basis of the Commission's Green Paper which was published in July 2005.

The EPFSF previously discussed the Mortgage Credit Green Paper on [14<sup>th</sup> of September 2005](#) and [12<sup>th</sup> of September 2006](#).

On the 14<sup>th</sup> of November 2006, the European Parliament adopted a Resolution on Mortgage Credit (ECON Rapporteur John Purvis PPE, UK and IMCO Rapporteur Manuel Medina Ortega, PES, ES) in response to the Green Paper. The European Parliament, along with respondents to the Green Paper, fully supported the Commission's suggestion to address "consumer protection" and "funding" aspects further through separate experts groups – the Mortgage Funding Expert Group (MFEG) and the Mortgage Industry and Consumer Dialogue (MICDG)<sup>1</sup>.

The European Commission published the terms of reference for the MFEG in February 2006 and announced the composition of the Group in March 2006. After eight meetings were held, the Final MFEG Report was published in December 2006.

A public consultation was held on the conclusions of the MFEG and MICDG Reports in early 2007, the results of which will feed into the White Paper on Mortgage Credit which is expected at the end of 2007.

### Characteristics of European Mortgage (Funding) Markets

Even though European mortgage markets do not exhibit a high degree of integration, national mortgage markets are very competitive as shown by various studies<sup>2</sup>. It has been argued in

---

<sup>1</sup> The MICD report, the scope of which is beyond this briefing, explored in detail four key consumer protection issues, namely pre-contractual information, advice, early repayment and the annual percentage rate of charge (APRC).

<sup>2</sup> See for example Deutsche Bank Research, October 19, 2006, "*Integration of EU Mortgage Markets - It's the funding, Commissioner!*", for a discussion and European Mortgage Federation/Mercer Oliver Wyman Study on Adjusted Price Analysis, February 2007.

responses to the Green Paper consultation that attempts to further raise competitiveness of European mortgage markets would be more efficient on the funding side than the mortgage origination side given national consumer preferences and consumer protection laws.

Indeed, the competitiveness of national mortgage providers is partly due to the high cross-border demand for mortgage-linked securities such as Covered Bonds, RMBS (Residential Mortgage Backed Securities) or Whole Loan Sales<sup>3</sup>, which allow firms to diversify exposures to other markets without a direct physical presence.

The close relationship between primary and secondary mortgage markets implies that the integration of European mortgage funding markets can facilitate mortgage integration by increasing efficiency, improving product diversity and fostering competition. The MFEG was mandated to assess obstacles to the mortgage funding market and to make recommendations on how to remove them.

Demand and supply of mortgage-linked securities has dramatically increased since the introduction of the Euro and such securities are playing an important role towards accessibility of mortgage loans and towards product innovation. While there are obviously lessons to be learned from the recent markets events, particularly in the US sub-prime sector, mortgage linked securities are still going to be an important source of funding. . However, increased levels of (indirect and direct) exposure by European investors to U.S. sub-prime mortgages have, in recent months, led to muted appetite for all types of European mortgage risk in whole loan or securitised note format.

#### Main funding instruments

##### **Covered Bonds**

Covered Bonds have a long history dating back to the first Pfandbriefe that originated in Germany in 1763. Covered bonds are securities generally backed by cash flows from mortgages or public sector loans which are legally and economically isolated from the issuing firm but remain on the issuer's balance sheet. Unlike RMBS, covered bond holders also have recourse to the issuing entity.

In recent years Covered Bonds have increased in popularity, in particular since the introduction of Jumbo Covered Bonds in 1995. Denmark and Germany account for the largest market shares of Covered Bonds with 32% and 27% respectively of all outstanding European Covered Bonds<sup>4</sup>. Various Member States have adopted (or are in the process of adopting) specific Covered Bond legislation in recent years, and 2006 saw the introduction of the first US Covered Bonds. European Covered Bonds currently amount to €1.9 trillion and account for 18% of mortgage funding in Europe<sup>5</sup>.

##### **RMBS**

Residential Mortgage Backed Securities (RMBS) first originated in the US and have been issued in Europe since the 1980s. RMBS comprises large amounts of residential mortgages transferred off-balance sheet and pooled into Special Purpose Entities which distribute cash flows to security holders. RMBS accounted for €245bn of issuance in 2006, representing 54% of Structured Finance issuance, with the largest proportion domiciled in the UK.<sup>6</sup>

#### The Mortgage Funding Expert Group Report

The report of the MFEG analysed obstacles to the emergence of an efficient and competitive pan-European mortgage funding market, and suggested solutions to remove existing barriers.

<sup>3</sup> Whole Loan Sales amount to the complete sale of a particular mortgage book from one originator of loans to another.

<sup>4</sup> Figures from Deutsche Bank Research, October 2006

<sup>5</sup> Figures from the EMF's ECBC, September 2007

<sup>6</sup> European Securitisation Forum, "ESF Securitisation Data Report, Summer 2007"

The Expert Group concluded that while European mortgage funding markets are already quite competitive and efficient, targeted legislative and non-legislative measures – at national or EU level – could further improve their functioning. Among the legislative measures proposed, the MFEG recommended enacting/updating Covered Bond and securitisation legislation, providing equal access to mortgage and land registers and agreeing convergence of valuation practices and the transparency of enforcement procedures.

In addition, the MFEG underlined the need for market driven standards and development of best practice reporting in order to increase transparency for investors.

---

---

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

Chair Administrative Committee  
*Guido Ravoet*, EBF  
Rue Montoyer 10, B-1000 Brussels, Belgium  
Tel: 0032 2 508.37.25  
E-mail: [g.ravoet@fbe.be](mailto:g.ravoet@fbe.be)

Secretariat  
*Francesca Mollica*, EPFSF Secretariat  
Av. de la Joyeuse Entrée, 1-5, B – 1040 Brussels  
Tel: 0032 2 504 80 40/ Fax: 0032 2 504 80 50  
E-mail: [fmollica@epfsf.org](mailto:fmollica@epfsf.org)

**Steering Committee**

Zsolt László Becsey MEP  
Pervenche Berès MEP  
Jonathan Evans MEP  
Robert Goebbels MEP  
Sophie In't Veld MEP  
Piia-Noora Kauppi MEP  
Wolf Klinz MEP  
Astrid Lulling MEP  
Gay Mitchell MEP  
Alexander Radwan MEP  
Dariusz Kajetan Rosati MEP  
Manuel António Dos Santos MEP  
Peter Skinner MEP (SC Chair)  
leke van den Burg MEP

**Financial Industry Committee**

ABN AMRO  
Alternative Investment Management Association (AIMA)  
APCIMS  
AXA  
Banco Bilbao Vizcaya Argentaria  
Barclays  
BNP Paribas  
Chartered Financial Analyst – Institute (CFA)  
Citigroup  
Comité Européen des Assurances (CEA)  
Commerzbank  
Deutsche Bank AG  
Deutsche Börse AG  
Euroclear  
Euronext  
European Association of Public Banks (EAPB)  
European Savings Banks Group (ESBG)  
European Banking Federation (FBE)  
European Mortgage Federation (EMF)  
European Federation of Accountants (FEE)  
European Venture Capital Association (EVCA)  
Federation of European Securities Exchanges (FESE)  
Fortis Bank  
Futures and Options Association (FOA)  
Goldman Sachs International  
International Capital Market Association (ICMA)  
ING  
International Swaps and Derivatives Association (ISDA)  
Intesa Sanpaolo Group  
JP Morgan  
Lloyds TSB  
Lloyd's  
London Investment Banking Association (LIBA)  
MasterCard Europe  
Merrill Lynch  
Morgan Stanley  
Nordea  
Prudential Plc  
Royal Bank of Scotland  
Securities Industry and Financial Markets Association (SIFMA)  
Société Générale  
Standard & Poors  
Svenska Handelsbanken  
UBS AG  
Unicredit  
VISA Europe  
Western Union International Bank