Finance Watch

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A Revised Mortgage Credit Directive

A path towards affordability, fair access and debt relief in EU housing

A Finance Watch Position Paper

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Introduction

Housing affordability is a key issue many Europeans are currently faced with. As a result, Commission President von der Leyen has declared housing one of the EU's key priorities in the new term. An important reason for the rising housing costs is the significant rise in mortgage rates in recent years. Data from the European Central Bank (ECB) shows that average housing costs have increased cumulatively by around 10.2% since the start of the interest rate hike cycle in 2022 which has led to a rise in variable mortgage rates.[1]

At the same time, the number of European households facing an unmanageable debt burden has risen and is set to increase further due to the long-term impacts of the COVID and cost-of-living crises. As confirmed by a report of the European Commission, the share of over-indebted households in the EU is expected to increase from 8.8% in 2020 to 11.3% by 2032.[2] As a result, according to the Eurobarometer survey, rising prices and the cost of living were the main reasons that drove people to vote in the European elections.[3]

In light of this, it is crucial that the Mortgage Credit Directive (MCD) is revised in the upcoming EU mandate to address excessive mortgage costs, prevent the mis-selling of mortgages to consumers who are unable to repay them, and to strengthen the rules on debt relief measures for existing borrowers who are struggling to repay their mortgages.

Key Takeaways

1. **Measures should be introduced to prevent excessive costs**
   Lenders should be obliged to offer both variable and fixed rate mortgages and consumers should be able to easily switch between the two. Tying and bundling of ancillary products should be prohibited as they add unnecessary costs.

2. **The creditworthiness assessment rules should be strengthened**
   The MCD rules should be aligned with the more appropriate creditworthiness assessment rules in the revised Consumer Credit Directive (CCD) to prevent mis-selling of mortgages to households that are unable to repay them, and prevent financial exclusion based on discrimination.

3. **Stronger forbearance measures are needed**
   The rules should be aligned with the revised CCD, prescribing specific forbearance measures and obliging creditors to exercise these measures in cases where consumers are facing financial difficulties.

4. **Non-bank lenders should be properly authorised and supervised**
   The rules should be aligned with the revised CCD, requiring the admission, registration and supervision of lenders and credit intermediaries that are non-credit institutions and non-payment institutions.

[1] European Central Bank (ECB), *How big is the household housing burden? Evidence from the ECB Consumer Expectations Survey*, 2024.
[2] European Commission, *Study on European consumers' over-indebtedness and its implications*, June 2023.
[3] European Parliament, *Cost of living is citizens' main concern at the start of the new legislature*, October 2024.

I. Measures should be introduced to prevent excessive costs

Since the pandemic and the cost-of-living crisis, the number of consumers struggling to repay their mortgages has risen significantly throughout the EU, impacting low-income households the most. One of the key reasons for this is that borrowers with variable rate mortgages have faced big increases in their mortgage rates due to the central banks' decision to raise interest rates. Variable rate mortgages are prevailing in a number of Member States such as Austria, Greece, Italy, Portugal and Spain.[4] Recent data from the ECB shows that in the first quarter of 2024, the proportion of lower-income households expecting to make late payments nearly doubled to 30%.[5] It is key that the MCD is revised to address the risk of egregious costs that can lead not only to financial distress but to over-indebtedness.

For one, there is a need to ensure that consumers across the EU can choose both fixed rate and variable rate mortgages. Variable rate mortgages can bear significant risks for consumers, in particular vulnerable consumers, who may take on these mortgages during low-interest periods, only to face steep rate hikes later, as seen recently. This is even more important for mortgage loans since they are of a very long duration (up to 30 years) during which the financial situation of a consumer can change significantly.

Therefore, it is key that the MCD mandates that lenders must offer both variable and fixed rate mortgages. This would ensure that consumers who are not able and/or willing to bear the risk of possibly higher variable rates are able to opt for alternative fixed rate options. Lithuania, where it has been difficult to obtain fixed rate mortgages, has recently drafted a law to this effect for exactly this reason. Under the new Lithuanian rules that will come into effect from 1 May 2025, creditors will be mandated to offer both variable and partially fixed interest rates to protect consumers who can't bear the risk financially from possibly high interest rate movements.[6]

In addition, for those who are already on variable rate mortgages but for whom these types of mortgages are unsuitable, the MCD should be revised to allow these consumers to easily switch to a fixed rate mortgage. Currently, the costs for switching a mortgage are very high in the EU, preventing consumers from changing providers and/or refinancing their mortgages.[7] Therefore, there is a need to introduce a cap for these costs. Several Member States have, for this reason, introduced caps for early repayment fees.[8] Introducing such a cap would not only allow consumers with unsuitable rates to switch to more suitable offers but it would also increase the overall competition between providers leading to lower interest rates on the market. It would also give providers a greater incentive to offer more favourable loan terms to existing customers in line with their situation.

[4] CEPS, *Over-indebtedness in a high inflation and high interest rate landscape*, 2024.
[5] ECB, *How big is the household housing burden? Evidence from the ECB Consumer Expectations Survey*, 2024.
[6] *Lithuanian lawmakers order banks to offer fixed-rate mortgages*, 2024.
[7] For example, see this information from the French consumer organisation Que Choisir: https://www.quechoisir.org/action-ufc-que-choisir-renegociation-de-credit-immobilier-les-pieges-des-banques-contre-les-consommateurs-n44140/.
[8] France, Portugal, Belgium, Latvia have introduced caps and Estonia and Lithuania are currently considering caps.

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Costs are also strongly driven up by ancillary products, such as payment protection insurance. Consumers are often obliged to purchase such products in order to get access to a mortgage, or to a more favourable interest rate. Such offers are often misleading, however, as the total cost of credit is higher with ancillary products. In addition, payment protection insurances only cover highly specific cases of incapacity to pay (e.g. death of the mortgage holder). To avoid high costs, tying should be strictly prohibited and bundling shall only be allowed under strict conditions. This would enable consumers to transparently compare the total cost of credit for different options offered by different providers and to terminate the contract for ancillary products separately from the mortgage at any time.

II. The creditworthiness assessment rules should be strengthened

Proper and adequate creditworthiness assessments are crucial to avoid both mis-selling of mortgage loans to consumers who are unable to afford them, and to prevent financial exclusion, i.e. denying someone a mortgage even though they are able to repay it.

In order to ensure an accurate creditworthiness assessment, it is key that the right type of data is used for the assessment. However, the current MCD rules on creditworthiness assessments are very high-level and do not provide any indication about what type of data should be used for the assessment. As a result, there is a high risk that lenders use irrelevant data, such as social media data or sensitive data that can lead to discrimination, exclusion and/or mis-selling.

Therefore, it is important that the creditworthiness assessment rules in the MCD are reviewed and aligned with the rules in the Consumer Credit Directive (CCD) which have been made more robust in the recent revision. To better align with the CCD, the MCD should explicitly prohibit the use of financially irrelevant data, such as social media data or sensitive data as per Article 9 of the General Data Protection Regulation.[9]

In addition, there is a need to adapt the creditworthiness assessment rules to the digitalisation trend of the market. Increasingly, creditworthiness assessments are performed by AI-assisted automated decision-making tools. While these tools bring benefits, such as efficiency and lower costs for firms to carry out the assessment, they also pose risks to consumers, such as errors or biases in the AI model which can lead to incorrect or discriminatory outcomes.[10]

The CCD review addressed this issue by providing the consumer the right to request and obtain from the creditor human intervention if the creditworthiness assessment involves the use of automated processing of personal data. This right includes obtaining from the

[9] Personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership, and genetic data, biometric data for the purpose of uniquely identifying a natural person, data concerning health or data concerning a natural person's sex life or sexual orientation. See: *General Data Protection Regulation*.
[10] Christian Stiefmueller, *The Soul of a New Machine: Promises and Pitfalls of Artificial Intelligence in Finance*, 2022.

creditor a clear and comprehensible explanation, as well as a review, of the assessment by a human. It is key that the MCD is updated and aligned with the revised CCD on this issue.

III. Stronger forbearance measures are needed

It is more important than ever that effective debt relief mechanisms are in place to help consumers who are struggling to repay their mortgages before having to face foreclosure proceedings. As mentioned earlier, EU consumers have been impacted by the economic consequences of both the pandemic and the cost-of-living crisis, which have led to a sharp decline in their disposable income and with it their living standards.

The forbearance rules in the MCD, however, are currently very weak. For one, unlike the updated forbearance provisions of the CCD, they do not oblige creditors to exercise forbearance measures in cases where consumers are facing financial difficulties. Nor do they prescribe any binding forbearance measures that must be considered. This must be changed to ensure that creditors have to consider reasonable forbearance measures in circumstances where consumers are in financial hardship.

In addition, the rules need to be changed to prevent creditworthiness assessments being used to deny consumers access to forbearance measures - a practice that is often witnessed in the market. The MCD should introduce a provision specifying that, while affordability checks are needed to ensure that any forbearance measure offered by the credit institution is sustainable and affordable for the consumer, an alternative and more suitable forbearance measure should be sought if a borrower fails the assessment. This would ensure that borrowers in difficulty are not automatically barred from accessing forbearance measures if they fail the assessment, and that any measure offered to them actually serves the purpose of making the debt affordable and manageable.

IV. Non-bank lenders should be properly authorised and supervised

An increasing number of non-bank lenders are entering the mortgage credit market.[11] Therefore, it is imperative that these entities are properly regulated and supervised. As confirmed by a recent report by the European Banking Authority (EBA), however, a significant number of non-bank lenders (NBLs) appear to apply inadequate practices with regards to creditworthiness assessments.[12] The same report also finds that the lack of a harmonised definition of non-bank lenders, as well as the lack of a regulatory framework for authorisation of these entities at EU level, may result in the different types of NBLs being supervised in different ways across EU Member States.

The revised CCD has addressed this issue for the consumer credit market by introducing rules for the admission, registration and supervision of lenders and credit intermediaries

[11] For example, see: European Banking Authority (EBA), *EBA Final Report in response to the nonbank lending request from the CfA on digital finance*, April 2022.
[12] EBA, *Report on the fact finding exercise on creditworthiness assessment practices of non-bank lenders*, August 2024.

that are non-credit institutions and non-payment institutions. The MCD should be aligned with the CCD and introduce similar rules to ensure that NBLs are properly regulated and supervised. It is absolutely crucial that the principle of "same service, same risk, same regulation" is also applied here.

V. There is a need for strong penalties and remedies provisions

Non-compliance with the MCD provisions by firms can lead to high financial detriment for a consumer, i.e. over-indebtedness and/or the consumer even losing their home. Therefore, it is key that there are strong penalties provisions in the MCD which are dissuasive and effective.

However, the current sanctions rules in the MCD do not specify how big the penalties for infringements of the rules by firms should be but merely state that they should be formulated by the Member States and be effective, proportionate and dissuasive. This bears the risk that the penalties applied by national competent authorities (NCAs) in the Member States are not dissuasive and effective and diverge across the Union. The sanctions regimes for financial services legislation in general are very diverse and often ineffective across member states and are in dire need of harmonisation.[13] Therefore, the MCD should be changed to specify how high that fine should be. As a minimum, the MCD penalties provisions should be at least 4% of the creditor or the credit intermediary's annual turnover, the same amount set for widespread infringements under the CCD.[14]

In addition, the rulebook should explicitly oblige Member States to ensure that consumers have access to proportionate and effective remedies, including compensation, for damage incurred and, where relevant, a price reduction or the termination of the contract. This is an area where the current MCD remains silent and would require updating.

VI. There is a need to streamline the pre-contractual information requirements, in alignment with the CCD

The pre-contractual information currently provided under the existing MCD rules is too long and complex. This results in a situation where consumers do not often read the pre-contractual information and/or do not understand key information before making a purchasing decision. What is essential is not the quantity of the information provided to a consumer, but that key details about the mortgage (e.g. all information about the costs, fees, consequences for defaulting on the mortgage, and/or late payments) are prominently and clearly communicated in simple, easy-to-understand language.

[13] See the *Finance Watch consultation response on supervisory convergence*, 2021.
[14] Official Journal of the EU, *Consumer Rights Directive*, 2024.

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Therefore, the MCD should introduce a similar provision as in the CCD stipulating that the key information a consumer needs to make an informed decision should be prominently provided on the first page of the disclosure form (the so-called European Standardised Information Sheet or ESIS). The rest of the information should be provided separately on the subsequent pages of the disclosure form. This will ensure that consumers see all the essential information upfront at a glance. It would also ensure that the pre-contractual information requirements are adapted to the technical constraints of digital devices (e.g. mobile telephone screens) which consumers increasingly use to purchase financial services.

VII. Barriers to ancillary insurance access by cancer survivors must be addressed

Studies show that many cancer survivors face exclusion with regards to mortgages. They are often denied the ancillary insurance required to take out a mortgage because of their medical histories, although they have been cured for many years, even decades.[15]

The mortality risks of oncological diseases have been significantly reduced thanks to developments in modern medicine. Survival rates for cancer victims are improving at an average annual rate of 3 percent and the life expectancy for survivors can be expected to be comparable to non-cancer patients. Despite this, only five EU Member States have currently implemented a 'right to be forgotten' for cancer survivors. The number of years survivors must wait to enjoy this right varies.[16]

Therefore, to ensure that cancer survivors have equal access to mortgages and mortgage-related insurance, the MCD should forbid insurers from considering past diagnoses of consumers' oncological diseases after a certain period of time has passed since their last treatment. A similar rule has been introduced in the new CCD rules. Such a period of time should not exceed 5 years starting from the end of the medical treatment of the consumer, in line with legislation in France and Belgium which is considered a best practice by the scientific community.[17]

Conclusion

Affordable housing and over-indebtedness are key issues that need addressing in the Commission mandate 2024-2029. Housing costs have significantly risen since interest rates were increased to combat inflation. At the same time, over-indebtedness has risen due to the impacts of these interest rate hikes and the cost-of-living crisis. Revising the MCD would help tackle the issues of affordable housing and over-indebtedness in the EU,

[15] https://www.*sciencedirect.com/science/article/abs/pii/S2213538320300382?via%3Dihub*.
[16] Ibid.
[17] Euractiv, *Belgium reduces waiting period for cancer survivors' "right to be forgotten"*, August 2024.

as it could address high mortgage costs and mis-selling of unaffordable/unsuitable mortgages, as well as provide relief to existing borrowers overburdened by debt.

Therefore, it is crucial that the upcoming evaluation of the MCD leads to a legislative revision of the directive early in the mandate 2024-2029. By tackling critical issues, such as simplifying the process of switching mortgages, strengthening creditworthiness assessment requirements and improving the forbearance measure provisions, a revised MCD can support a fairer housing market for EU consumers.

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