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OVERVIEW OF BORROWER PROTECTION IN MORTGAGE MARKETS

EGYPT FINANCIAL SERVICES PROJECT
TECHNICAL REPORT #68

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EXECUTIVE SUMMARY

This report is part of the legal and regulatory reform component of Task 1 under the Egypt Financial Services Project. The report seeks to inform on the uptake and the effectiveness of borrower protection regimes in other countries with long experience in mortgage markets and provides recommendations for development of borrower standardized protection in Egypt.

Background: Currently there is no standardized borrower protection in Egypt. The mortgage market is in its infancy, which provides an opportunity to draw from the lessons learned in other countries and implement best international practices.

Objective: The main objective is to review the borrower protection legislation in other countries, compare best international experiences and provide recommendations for development of standardized borrower protection in Egypt.

Methodology: The methodology employed was a combination of (a) a detailed review of borrower protection laws and regulations in the United States, (b) a detailed review of borrower protection laws and regulations in the European Union, (c) review of best international practices in the area of standardized borrower protection, (d) direct interviews and meetings with senior officials at the Mortgage Finance Authority, (e) direct interviews with mortgage finance companies Egyptian Housing Finance Company and Taamir Mortgage Company, (f) direct interviews with large banks including Egypt Arab Land Bank, Societe General, and Faisal Islamic Bank.

The development of consumer protection policy is one of the key issues that policy makers need to address in development of mortgage markets. President Kennedy addressed consumer protection policy in his speech on March 16, 1962, and outlined four basic consumer rights – the right to safety, the right to be informed, the right to choose, and the right to be heard[1]. Since then, consumer policy has developed around the world, however, consumer protection principles remain the same and are important for any mortgage lender or policy maker wishing to understand the consumer better.

A sound and modern borrower protection policy is a precondition for borrower confidence, which in turn, is important to the development of mortgage markets. To play their role as active players in the mortgage market, borrowers must feel fully confident and trust the system. This includes the objective of empowering borrowers to make informed choices in complex markets and promote their own interests.

The report stresses that there are no identical systems and that models developed in different countries are only indicative. Furthermore, the report emphasizes examples of best practice across different models.

The aim of the borrower protection legislation is to ensure transparency of information and comparability. As experience in other countries suggests, the introduction of borrower protection standards in Egypt would favor development of mortgage lending and increase the standards of the mortgage market.

[1] International Union for Housing Finance Newsletter November, 2003.

RECOMMENDATIONS

The principal recommendations are divided into the following categories:

A. Standardized Information Form

In the area of borrower information and product transparency, the creation of a standardized information form is a true alternative to a legal regulation regime. The standardized information form will be provided to the borrower at the advertising stage voluntarily by the mortgage lender.

The standardized information form could include, but not be limited to, the following: administration or handling charges, any other charges involved, total amount borrowed and payable (including installment amount, calculation and operation of installments), form of product, the cost of the early repayment fee (including worked examples of the charge).

The drafting of the standardized information form and the voluntary implementation by the mortgage lenders would create a unified minimum standard in Egypt for borrower information and product transparency.

The voluntarily implementation of the standardized information form can be accomplished through the Egyptian Mortgage Association (EMA) in cooperation with the Mortgage Finance Authority and mortgage finance companies without adopting new legislation. A register can be held within the EMA where the mortgage finance companies can register and sign to voluntarily implement the standardized information form.

B. Borrower Protection Legislation

It is recommended to draft the necessary legislation and forms to regulate standardized borrower protection. The objective of the new legislation should be to introduce transparency and consistency in the provision of information to borrowers by lenders about mortgage credit offers. Furthermore, the goal of the new borrower protection legislation should be to help borrowers eliminate unnecessary fees, to protect borrowers especially women and the poor against lender's discrimination, and to provide standardized borrower protection during the mortgage process.

C. Education and Awareness on Borrower Standardized Protection

Major stakeholders should:

- raise public awareness of the need for borrower protection including new legislation,
- define the type of support each will provide for this initiative, and
- organize, undertake, and attend educational programs.

I. BORROWER ATTITUDES

A. Borrowers and Mortgage Loans

Buying a flat or a house is the most expensive financial commitment most people ever make. Given the amount of money and the time periods involved, getting a mortgage is for many borrowers, the single most important financial decision of their lives. Moreover, as a result of increasing property prices, mortgages involve larger amounts of money and longer lengths of time, with mortgage repayments constituting one of the most important expenditures for borrowers throughout most of their working lives.

The main purpose of borrower standardized protection is to defend the right of borrowers to access the necessary information in order to allow them to make informed choices about this most important decision.

In the case of mortgage loans, and especially given the important amounts of money and time periods involved, borrowers must have easy access to clear, concise, and standard information in order to allow them compare different mortgage offers so they can make the mortgage decision that best suits them and their circumstances.

B. Borrower Attitudes and Psychology in the Mortgage Markets

This section analyses the borrower's attitude, psychology and basic needs, based on studies, experiences, and lessons learned in developed and seasoned mortgage markets, particularly those of the United States and Western Europe. However, whenever possible, examples and comparisons are drawn from the EFS Report "Knowledge, attitudes, and behaviors of Cairo flat/house owners and potential owners: a baseline survey". This is the first survey of potential borrowers in the mortgage markets carried out in Egypt.

During preparation of this section, the results of the survey were very helpful to understand the situation in Egypt and how borrowers make their decisions about mortgages. In summary, the review of the market research survey, as well as lengthy interviews with mortgage finance companies EHFC and El Taamir, commercial banks, attorneys, university professors, appraisers, real estate professionals on the subject, show that the information the borrowers say they need is predominantly focused on the total price, the monthly installment payments in order to assess affordability, and the maturity of the loan.

Surveys performed in other countries with developed mortgage markets do consistently and unequivocally reveal that price is the dominant determinant in the mortgage decision by households[2]. The importance of price is also supported by many studies and research worldwide from both government and private sector. For example, a survey performed by the UK Mortgage Code Compliance Board showed that price issues (interest rates, discounts, and amounts offered) were the most important factors for the household when deciding to apply for a mortgage loan[3].

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[2] "The Borrower Drivers of Mortgage Chum" Nick Young, Housing Finance, 2003.
[3] UK Mortgage Code Compliance Board, Borrower Research Report, 2003.

Ranking of Important Questions Concerning Mortgages

	1st Rank	2nd Rank	3rd Rank	Total	%
Would the interest rate on the mortgage be low enough to be acceptable to me?	157	77	59	293	58
Could I afford the monthly installment payment I would need to make?	62	58	59	179	35
How many years could I use to pay back my mortgage?	57	66	53	176	35
Am I personally willing to take on long term debt?	41	52	36	129	26
Would taking out a mortgage be acceptable by my religion?	49	39	23	111	22
Is my job or income secure enough to ensure that I could make my mortgage payments over time?	23	26	44	93	18
Could I get the house I want officially registered so I could qualify for a mortgage?	7	26	22	55	11
I KNOW I WOULD NEVER TAKE OUT A MORTGAGE	4			4	1
I HAVE NO IDEA. I CANNOT ANSWER THIS.	30			30	6

EFS Baseline Survey, Eric Abbott, EFS, 2005

Results of the EFS survey indicate that finding an acceptable interest rate is by far the most important question, followed by how many years it would take to pay off the mortgage, and what the monthly installment payment would be. Twenty-six percent were concerned about taking on long-term debt. Another 22% indicated they were concerned about whether or not taking out a mortgage would be acceptable to their religion. One other common concern was whether or not their job would be secure enough to ensure that the monthly payments could be made over time[4].

- **Borrower Psychology**

As established previously, borrowers make decisions based primarily on price, and therefore, the competition raises standards throughout the mortgage market. Accordingly, borrowers consider their personal financial situations, determine what they can afford, and then shop around to find the best deal. Therefore, borrowers exercise competitive pressure on mortgage loan providers who have to come up with innovative and improved services or face the threat of losing customers or falling to attract new business.

Surveys do consistently and unequivocally reveal that price is the dominant factor. Evidence from interviews with mortgage companies correctly notes that price is the deciding important factor, and is supported by research and borrower survey performed by EFS. The survey also showed the price issues were the most important factor and outweighs other non-price factors as key influencers in mortgage decisions.

While prices are an important factor, other factors are also at work which affects borrower decision making in the mortgage market. Some of these factors are: security, anticipated regret, the need to follow the majority, trust, and false assumptions. Each of these will now be discussed.

[4] "Knowledge, attitudes, and behaviors of Cairo flat/house owners and potential owners: baseline survey", Eric Abbott, EFS, 2005.

B1. Security Issues

Security is an important factor in the decision making process by borrowers, in terms of their financial situation and overall financial security. Security issues are related to and influenced by borrower confidence, a concept that was first calculated in the 1950s. Back then, the key psychological element in confidence was stability. Now, according to experts, many younger borrowers are happy to have a little instability, because it offers possibilities as well as drawbacks[5]. An unstable labor market, for example, may mean people fear being sacked, but it also offers the chance for profitable job-hopping. This increase in "risk-seeking" behavior, economists say, means that unconfident borrowers are not necessarily unhappy ones. In the mortgage market area the recent trend in many countries has been towards more variable rate mortgage products and away from fixed rate mortgage products.

B2. Anticipated Regret

Anticipated regret arises when the borrower takes into account future events that might adversely affect a mortgage decision. A classic example of this situation is the interest rate risk a financial savvy and careful borrower during times of low interest rates would choose a fixed rate deal in order to be able to protect against potential rate rises. Of course, especially in a rising market which often accompanies low rates, the buyers may have to take into consideration the risk of not getting into the market and perhaps missing the opportunity for a "good deal."

Another example related to this issue is the reluctance to apply for a long term mortgage if the borrower is considering the possibility of moving from the area. In that case, borrowers have to investigate if they will able to sell in the current local market. If borrowers cannot sell, they will not be able to buy and apply for a new mortgage in the new location. This may result in a situation where the lenders have much power over a borrower's movement and plans.

It must be emphasized that anticipated regret is only based on the information borrowers have at the purchase stage. It might be assumed that an older borrower is possible better positioned than a first time home buyer to anticipate possible negative outcomes based on previous experiences and circumstances.

B3. Follow the Majority

Borrower decision-making can be influenced by their social environments. Borrowers may choose different products because of social factors such as personal preferences or those of their friends and family and not simply the economic factors. For example, they choose to buy specific products with brand names, not because they can better afford them, but because they are socially acceptable.

Social pressures may be a major factor for borrowers to take out a mortgage even if the risks appear high. In the US market which is characterized by high owner occupancy rates and rising house prices, the very act of not missing out in a rising mortgage market may be a powerful determinant in decision making. According to research conducted in the US and Canada on this subject, there is definite evidence of social pressures;

[5] Peter Lunt, Senior Lecturer on Borrower Psychology at University, BBC News September 21, 2001.

borrowers are very much influenced by how people around them behave in their decision making process[6].

B4. Trust

Given the increasing complexity, especially in mortgage products, borrowers rely heavily on a level of implicit trust that they place in the lender. This trust relationship may result in the buyer following the recommendation of the lender. Unless constrained by a system of checks and balances, there may be a temptation for the lender to take advantage of this trust relationship.

B5. False Assumptions

The experience of most developed countries which have satisfactory borrower protection legislation in place, shows that it appears that borrowers make false assumptions or set too high expectations on their rights. Borrowers can by no means understand all the legal issues involved in a mortgage transaction as well as the complicated relation between security and credit.

So it seems that in many situations, borrowers often think they enjoy a higher level of state protection than they really do. This ultimately may suggest that borrowers enter the mortgage buying process thinking they are somehow automatically protected:

- Borrowers might think that lenders are obliged to point out certain types of information in advertising and pre-contractual literature, when in fact, experience has shown that lenders only provide information they want borrowers to see;

- Borrowers might think they can seek redress to the lender if something were to go wrong, yet experience shows that lenders do not necessarily have the appropriate redress mechanisms in place;

- Borrowers might think that lenders are adequately trained to advise them on the product appropriate to their needs. Yet, perhaps this is not always the case.

C. Borrower's Basic Needs in Mortgage Markets

The previous part focused on several factors influencing borrower's decision like social pressures, social norms, trust in lenders/intermediaries, and false assumptions about protection. This part focuses on borrower's basic needs to make an informed decision.

One of the most important issues in the decision making process by the borrowers is how the information is presented to the decision maker (the borrower). In order for borrowers to be able to take rational and informed decisions:

- they should be given the correct and appropriate information;
- the information should be presented to them in an efficient and simple to understand manner; and
- an appropriate borrower protection infrastructure should be in place to ensure lenders provide redress in the event of delay or wrongdoing.

[6] "Instrument Choice: The Demand for Mortgages in Canada" by J. Breslaw, I. Irvine and A. Rahman, Journal of Urban Economics, 1996.

The main goal for the policy makers in establishing a new and successful mortgage market is to create a level playing field between lenders and borrowers. This is in the best interest of all parties involved because it will result in development of the mortgage market. Listed below, are several basic needs of the borrower to feel secure and provided with good and reliable advice.

C1. Information and Transparency

The best advice should be duly considered with respect to the effect on their household liquidity, the conditions governing those events which are feasible but mostly unexpected, the effects offering their home as security has on their future mobility, expectations and economic freedom.

Other considerations are the protection against market changes affecting their installments and household liquidity for unforeseen events, and the foreseeable weakness in such conditions to reach an adaptation of their contracts and protection against the possibility to exploit weaknesses of borrowers.

Borrowers would only be served if high levels of transparency exist. A more developed market envisages the entry of even more lenders, and may result in more conditions even more saturated and confusing than at present. So, requirements for standardized financial disclosure at the pre-contractual stage to assist borrowers would be essential.

C2. Security

Mortgage credit is especially dangerous for borrowers because it ties their income for the rest of the maturity of their mortgage loan into installments. If their income does not remain stable, or if unforeseen expenditures burden their income, they have to carry the risk of defaulting on their payment. This is even more dangerous in Egypt since the borrowers sign checks to guarantee their payment on the loan and risk going to jail if they default in their mortgage payment. These high risks need borrower protection to help them understand their situation, their rights and obligations from the start of the process, and to protect them from additional burdens.

C3. Different and Better Choices

Borrowers could have access to better and more adapted mortgage credit on markets if they could understand the implications of credit, and could compare its benefits and costs to other credit. But in all these basic conditions for a demand driven market the supply side has an enormous advantage.

C4. Advice

The key section in many borrower protection legislations in other countries covering required conduct for advised sales rules is the “suitability assessment”. Before recommending a particular mortgage to a customer, firms might be required to take reasonable steps to ensure that the mortgage is suitable for the particular borrower.

This is of critical importance not only because it will govern advice that evidence suggests is very influential in borrowers’ decision-making, but it will also be a benchmark in subsequent consideration of complaints by the borrower.

There are three key suitability criteria for a mortgage: (i) that the customer can afford the mortgage; (ii) that the mortgage is appropriate to the needs and circumstances of the customer; and (iii) that the mortgage is the most suitable of those that the lender has available.

To assess affordability, a mortgage company should give due regard to:

- information that the customer provides about his income and expenditure, and any other resources that he has available;
- any likely change to the customer's income, expenditure, or resources; and
- the costs that the customer will be required to meet once any discount period in relation to the regulated mortgage contract comes to an end (on the assumption that interest rates remain unchanged).

It should be noted that there is potentially a danger in overly prescriptive regulation of advice, but the issuance of guidance rather than detailed rules could avoid this.

Last but not least, borrowers need special protection in mortgage credit. Borrowers need rules for better borrower information and rules which protect them against harsh conditions.

II. TYPES OF BORROWER PROTECTION AND LESSONS LEARNED

A. Characteristics and Types of Mortgage Loans

Eugen von Böhm-Bawerk in his 1890 book "Capital and Interest" provides his much-quoted summary which cut through different interest-rate theories and gave us the definition used in economics classrooms today: "The loan is a real exchange of present goods against future goods."

"Present goods invariably possess a greater value than future goods of the same number and kind, and therefore a definite sum of present goods can, as a rule, only be purchased by a larger sum of future goods. Present goods possess an agio in future goods. This agio is interest. It is not a separate equivalent for a separate and durable use of the loaned goods, for that is inconceivable; it is a part equivalent of the loaned sum, kept separate for practical reasons. The replacement of the capital + the interest constitutes the full equivalent."[7]

This brings us to better understanding of characteristics and types of the mortgage products. A mortgage is a relatively simple financial product where a loan for the purchase of property is made, paid back with interest, and secured on the collateral of the property purchased. The mortgage indicates that a specific amount of money will be loaned at a specific interest rate so that the borrower can buy his/her home.

While it seems there is a wide range of mortgage products in the market, there in fact are only two main types of mortgage products: fixed rate and variable rate. Clearly, the main difference from the borrower's point of view is the variability of interest charged, but from the lender's perspective, the way that these are funded may also differ. Islamic

[7] "Capital and Interest" by Eugen von Böhm-Bawerk

mortgages are the only other type of loan that seem truly different in structure; designed to comply with Shari'a law.

With fixed rate mortgage loans, the interest rate the mortgage monthly payments remain fixed for the period of the loan. Fixed-rate mortgages are available for 10, 15, 20, 25 years and 30 years. Generally, the shorter the term of a loan, the lower the interest rate.

Another version of fixed rate mortgages is a balloon loan. Balloon loans are short-term fixed rate loans that have fixed monthly payments based usually upon a 30-year fully amortizing schedule and a lump sum payment at the end of its term. Usually, balloon loans have terms of 3, 5, and 7 years. The advantage of this type of loan is that the interest rate on balloon loans is generally lower than 30- and 15-year mortgages resulting in lower monthly payments. The disadvantage is that at the end of the term the borrower will have to come up with a lump sum to pay off the lender. We expanded on this particular loan product because it is a version of fixed rate; therefore, it complies with requirements and it could be offered as a new loan product by mortgage companies in Egypt.

A variable or adjustable loan is a loan whose interest rate, and accordingly monthly payments, fluctuates over the period of the loan. With this type of mortgage, periodic adjustments based on changes in a defined index are made to the interest rate.

Within the basic structure of fixed and variable rate mortgage product types there are many variations. Product proliferation has largely been driven by competition to affect the pricing and features of these main products. Lenders have been able to tailor pricing and product features to meet the more precise requirements of customers, mainly by achieving better management of risk and control over profits and volume of sales.

The Features of Different Mortgage Products

Loan Products	Variable-Rate	Fixed Rate
Funding	Deposits Bonds Secondary markets	Deposits Bonds Secondary markets
Product Features	Variable interest rate. The lender avoids the mismatch between long-term lending and short-term deposits.	Fixed interest rates are typically offered for shorter periods. However, if funding is provided through borrowing in the bond market the mortgage loans could be offered for up to 30 years or more. Most commonly, through financial contracts the lender hedges the mismatch between long-term lending and short-term deposits.
Borrower advantages	Often lower interest rates at time of issuance given a normal interest rate environment	In connection with fixed interest rates, future payment on the loan will be known. Provides protection against

		rising interest rates.
Borrower disadvantages	Borrower bears the risks of interest rates rising. Rates are not always linked to a fixed index. Spreads (margins) are not fixed throughout the term of the loan.	In general, higher interest rates than variable rates. Borrower bears the risk of falling yields.
Mortgage finance companies drawbacks	Liquidity risks	Interest rate transformation and liquidity risks.

On the borrower's side, the choice between fixed and variable rate mortgages can depend on a number of factors. Some borrowers like to be sure of their payments over a certain period, while others will take a considered view about how interest rates might move in the future, and choose accordingly. However, it seems that many take a short-term view, and choose the most popular rate at the time.

While there remain two main types of mortgages, it should be noted that the range of mortgage product characteristics have evolved enormously, especially recently. Pricing will vary according to risk, circumstances of the borrower, the size or purpose of the loan or the loan to value ratio; furthermore, it could depend on the lender's strategy. While the basic structure is the same, it seems there are thousands of products with many lenders offering about 40 different types of mortgage products[8].

B. Transaction Costs

Transaction costs are the price the borrower has to pay when purchasing a mortgage loan, or changing mortgage providers, that is to say, loan cost. In Europe, loan costs include property valuation, solicitor/notary fees associated with loan purchase, mortgage registration costs, taxes associated with the loan, administration agency costs and other loan costs including lender charges for the loan. In some countries, many of mortgage-related fees are added to the loan which improves mobility but costs are still born by the borrower[9].

In the United States, the settlement process covers the costs associated with the mortgage loan process. Below are listed the main settlement costs which include the following:

- Sales/broker's commission which is usually paid by the seller;
- Items payable in connection with loan which are fees that lenders charge to process, approve and make the mortgage loan;
  - Loan origination fees or sometimes is called a "point" or "points." It covers the lender's administrative costs in processing the loan. Often expressed as a percentage of the loan, the fee will vary among lenders. Generally, the buyer pays the fee, unless otherwise negotiated;
  - Loan discount: Also often called "points" or "discount points," a loan discount is a one-time charge imposed by the lender or broker to lower

[8] "Mortgage Lending Analysis" by James Tatch, senior statistician and Janet Vass, senior economist, Council of Mortgage Lenders, 2004.
[9] "Study on Integration of European Mortgage Markets", European Mortgage Federation, Mercer Oliver Wyman.

the rate at which the lender or broker would otherwise offer the loan. Each "point" is equal to one percent of the mortgage amount. For example, if a lender charges two points on a $80,000 loan this amounts to a charge of $1,600;
    - Appraisal fee which pays for an appraisal report;
    - Credit report fee which covers the cost of a credit report, which shows the credit history;
    - Lender's inspection fee which covers inspections, often of newly constructed housing, made by employees of lender or by an outside inspector;
    - Mortgage insurance application fee which covers the processing of an application for mortgage insurance;
- Title charges may cover a variety of services performed by title companies and others. The settlement may include the following: settlement or closing fee which is paid to the settlement agent or escrow holder; charges to cover the costs of the title search and examination; document preparation, notary/attorney fees; title insurance which includes the total cost of owner's and lender's title insurance.

C. Characteristics and Types of Consumer Protection

The object of Egypt's disclosure procedures and forms should be to improve and standardize consumer information and help prospective borrowers choose the mortgage loan best suited to their needs. By standardizing the information, the mandatory disclosure is intended to help develop mortgage transactions and boost competition in the Egyptian mortgage market. Although, the Egyptian mortgage market is still in its infancy, it is in the unique position of drawing from the experience and lessons learned in other developed mortgage markets.

There are several types of borrower/consumer protection, which have been tried in the U.S. and other countries. The most common types are as follows: product controls, behavior controls, price controls, and mandatory disclosures.

C1. Product Controls

The product controls (pre-1980 in the United States) consist on offering only fixed-rate mortgages. Borrowing short to lend long was the financial structure followed by Savings & Loans (S&L) banks in the United States until the 1980s. S&Ls used short-term savings to fund long-term, fixed-rate home mortgages. The dangers inherent in this "maturity mismatching" became evident every time short-term interest rates rose. S&Ls, stuck with long-term loans at fixed rates, and often had to pay more to their depositors than they were making on their mortgages.

Therefore, during periods of high interest rates, S&Ls, limited to making long-term, fixed-rate mortgages, earned less interest on their loans than they paid on their deposits[10].

Furthermore, on loan contracts, in the case of fixed-rate mortgages, there are issues with negative amortization and prepayment penalties, among others.

C2. Behavior Controls

[10] "Savings and Loan Crisis" by Bert Ely

Behavior control consists of two major rules for lenders. They must assess borrower's ability to repay and they must assure that the borrower benefits from the transaction.

Traditionally, lenders have gathered information by using a mortgage application form and this is reinforced by additional facts collected at a face-to-face interview.

The data collection enables the lender to assemble information about the applicant's financial circumstance (status) in order to assess if the customer will be able to service the repayments on the loan. Also, the lender assembles information relating to the property on which the loan will be secured.

This represents a 'belt and braces' approach. If the borrower's ability to service the debt deteriorates, the lender can rely on the security to recover the outstanding debt. Assessment of 'ability to repay' and valuation of security go hand in hand but it is the first of these, which is most important.

Even with excellent security, there is no point in lending to a person who will find it difficult or impossible to maintain regular repayments. Such a situation causes stress and hardship for the customer and can lead to unnecessary administrative work and loss for the lender.

C3. Price Controls

The study of price controls teaches important lessons about a free and competitive market. We gain an appreciation of its efficiency by examining cases in which controls have prevented or affected the formation of market prices. This does not mean that there are no circumstances in which temporary controls may be effective. But a fair reading of economic history shows just how rare those circumstances are[11].

Generally speaking, the appeal of price controls is easy to define. Even though they fail to protect many consumers and hurt others, controls hold out the promise of protecting groups of consumers who are particularly hard pressed to meet price increases. Thus the prohibition against usury—charging high interest on loans—was intended to protect someone forced to borrow by desperation. A non-lending example is rent control to protect those who rent at a time when demand for apartments appears to exceed the supply leaving landlords free to "gouge" tenants.

But, despite the frequent use of price controls and the superficial logic of their appeal, economists are generally opposed to them, except perhaps for very brief periods during emergencies. The reason is that controls on prices distort the allocation of resources[12]. Price controls were common practice 30-40 years ago until they proved generally ineffective.

Conclusion: The product, behavior, and price controls must be avoided because their disadvantages outweigh their advantages (check back).

C4. Mandatory Disclosure

Mandatory disclosure is the main type of consumer protection recommended.

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[11] "Price Controls" by Hugh Rockoff
[12] "Price Controls" by Hugh Rockoff

- In principle, mandatory disclosure can make markets work better by empowering borrowers; also,
- It overcomes "information asymmetry", an issue important for the secondary mortgage markets; it relates to the amount of information on mortgage loans by mortgage originators and secondary market players. The secondary market companies have to somehow trust the mortgage originators, because they do not have the resources to check on every mortgage loan. The mandatory disclosure helps to overcome the "information asymmetry".

Disclosure has two elements related to each-other, reporting to the respective supervising authorities and disclosing the information to the consumers.

However, intelligent and balanced reporting is needed. Mandatory disclosures with excessive information are needlessly expensive for lenders and may overload borrowers with too much information. Mandatory disclosure of poorly chosen information does not help consumers and meets no policy objectives. For complex products, regulators should carefully examine disclosure options or risk consumer confusion on a broad scale.

An example of borrower protection in the United States is disclosure regarding settlement costs. At various points during the loan application process, the borrower is entitled to get estimates of the costs and fees associated with getting a mortgage and going through settlement. Some of these requirements in accordance with different acts are as follows:

- **The "good faith estimate"**
  The Real Estate Settlement Procedures Act (RESPA) requires the mortgage lender to give the borrower a "good faith estimate" of all closing costs within 3 business days of submission of application for a loan. This is a good faith estimate, but the actual expenses at closing may be slightly different.

- **Truth in lending information**
  For home purchases, the lender is required, under the Truth in Lending Act, to provide a statement containing "good faith estimates" of the costs of the loan within 3 business days of submission of the application. This estimate will include the total finance charge and the annual percentage rate (APR). The APR expresses the cost of the loan as an annual rate.

- **The "HUD-1" statement**[13]
  The Real Estate Settlement Procedures Act (RESPA) also requires the lender to give the borrower a copy of the HUD-1 or HUD-1A Settlement Statement 1 day before the borrower goes to settlement, if the borrower requests it. This final statement of settlement costs will show all the fees and charges borrower will be expected to pay at settlement (provided no "adjustment" occur at settlement).

- **Prohibited Fees**
  It is illegal under RESPA for anyone to pay or receive a fee, kickback or anything of value because they agree to refer settlement service business to a particular person or organization.

[13] US Department of Housing and Urban Development

In the European Union, the European Credit Sector Associations led by the European Mortgage Federation and Consumer Organizations, have worked towards voluntary disclosures of pre-contractual information on home loans by lenders (mortgage companies or mortgage banks depending on each country's mortgage legislation).

Section IV discusses borrower standardized protection in the United States and in the European Union in more detail.

III. BORROWER PROTECTION

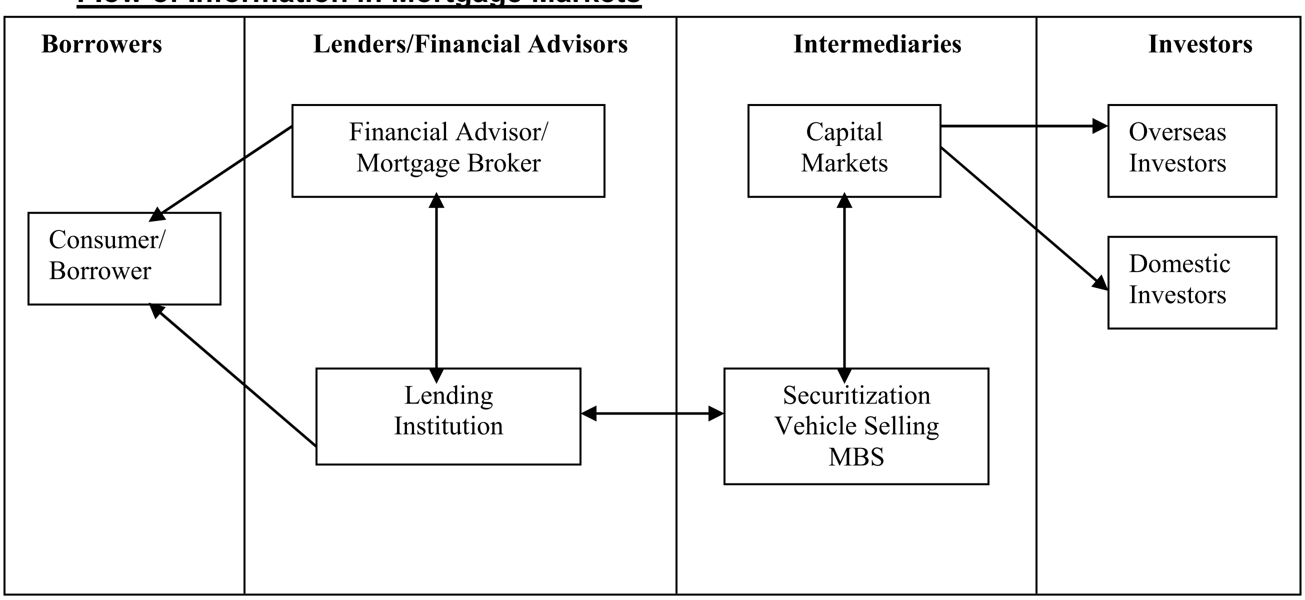
A. Information

Information provision is a crucial issue in mortgage transactions, given their complexity, relative high cost and long duration. A degree of information asymmetry between the average borrower and the loan provider is inevitable. What is crucial in this context is that the borrower is provided with the appropriate level of information necessary to take an informed decision, in a manner and at a time when such information provision is most effective.

Borrowers should have a fair opportunity of access to all available services and products, and protection against all discrimination based on the source or the amount of income.

Furthermore, borrowers should obtain an accurate picture of the costs and consequences of a loan. The disclosure of the cost of borrowing should be complete, exhaustive and correct. It should fully meet the evidentiary and warning functions of formalities and provide details of future payments in order to give the necessary information on liquidity.

Flow of Information in Mortgage Markets



A1. Informational Borrower Protection

Borrower protection can be increased through improved information rights as follows:

- Information to be provided at an early stage offering the borrower sufficient time for reflection before entering into a contract; such information should be free of charge, easy to access and without any constraints;

- All information to be personalized as far as possible and tailored to the specific demand and needs of the borrower with respect to his/her actual present and future financial situation;

- Concrete information in money terms, which can be related directly to the borrower's cash flow is more valuable than abstract information in percentage rates or other parameters;

- In relation to loan agreements, there should be a repayment plan set out in a form prescribed by law. All information relating to payments should be broken down into monthly amounts;

- Borrowers to be informed expressly of their rights to repay loans early with or without penalty;

- In addition to giving written information at the pre-contractual stage, providers should be compelled to inform borrowers orally about this information in order to satisfy themselves that borrowers have understood the information and in order to answer any queries. In particular, this would assist borrowers with limited education, who may have difficulties reading the information.

B. Early Repayment

Early repayment of the loan is one of the most crucial aspects of the mortgage credit. The lengthy duration of mortgage contracts, the change of key contract conditions in this duration (like interest rate changes) or other personal or financial reasons may motivate the borrower to seek a premature exit from the mortgage contract. Early repayment fees are the price to be paid by the borrower for this premature exit.

The right to early repayment provides for effective discharge which is possible only if the borrower can repay his debt at any time.

Also, the mortgage contract might include the entitlement to early repayment, as well as the procedure to be applied by the borrower in order to exercise this right. Furthermore, in the event of early repayment, the borrower might be entitled to request and receive a detailed statement of account, free of charge, allowing them to verify the charges and interest claimed.

Early repayment regimes vary widely in different countries. In some, they are highly regulated and in others they are a matter of private contract law between borrower and lender, with the borrower only having a choice between different kinds of standard contracts and mortgages, as opposed to a real opportunity to negotiate individual terms.

Early repayments are generally attached to fixed interest rate mortgage products, with the fee applying to a departure during this 'fixed' period. Early repayment fees are said to reflect the funding structures in place to support the product, and have a direct impact on competition and on product diversity and availability.

C. Advice Provision

Although, covered in the previous section, this principle bears repetition as it is one of the most important issues of standardized borrower protection. The main reason is that mortgages are complex high value products. Because of their complexity and financial importance to borrowers, advice on mortgage products tends to be sought more often than on most other financial services products. Different kinds of borrowers may have different kinds of needs from their providers and different kinds of relationships with them.

However, on the other hand, it should be noted the important role adequate advice provision can play on borrower confidence and in the prevention of problems such as over-indebtedness. In final analysis, we argue in favor of including such a provision in borrower standardized protection legislation.

D. Protection of Privacy

Protection of privacy of the borrower is important and it is related to the collection and processing of data gathered by the lender during the loan application and verification process.

It is essential to the protection of borrower's privacy that personal data obtained from borrowers, or any other persons in connection with the conclusion and management of loan agreements, be processed only for the purpose of assessing the financial situation of those persons and their ability to repay.

E. Usury Rules

Many countries have usury rates or rate ceilings which prevent exorbitant pricing in credit and a systematic exploitation of borrowers who feel or are personally forced to take up credit.

According to the administratively-fixed rate ceilings preferred in many countries the rate ceiling is normally fixed according to a market rate at about 150 to 200% of the average market rate in borrower credit. This margin gives enough space to allocate different risks and service intensity in borrower credit and have proved to be acceptable to the credit industry.

F. Enforcement and Redress

Enforcement and redress are important tools to protect borrower's interest. It should be noted that judicial redress mechanisms can be lengthy and costly for borrowers. Non-judicial mediation or arbitration can be useful ways to settle disputes but should be independent and efficient in order to be acceptable to users.

IV. INTERNATIONAL BEST PRACTICES

A. Regulation of Borrower Protection in the United States

A1. The Equal Credit Opportunity Act

The Equal Credit Opportunity Act (ECOA) prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, or because an applicant receives income from a public assistance program.

The Department of Justice may file a lawsuit under ECOA where there is a pattern or practice of discrimination. In cases involving discrimination in home mortgage loans or home improvement loans, the Department may file suit under both the Fair Housing Act and ECOA.

Appendix

Other federal agencies have general regulatory authority over certain types of lenders and they monitor creditors for their compliance with ECOA. ECOA requires these agencies to refer matters to the Justice Department when there is reason to believe that a creditor is engaged in a pattern or practice of discrimination which violates ECOA. Each year, the Department files a Report[14] with congress on its activities under the statute.

The types of credit transactions that are protected by the ECOA include, but are not limited to, business loans, consumer leases, consumer loans, auto loans, credit cards, agricultural loans and loans to purchase, improve, refinance or construct residential or commercial real estate.

When enacted in 1974, the ECOA prohibited discrimination on the basis of marital status and sex. In 1976, the Act was amended to designate other prohibited bases of discrimination, including race and national origin.

Over the years, several significant amendments have been made. In 1989, the ECOA was amended by the Women's Business Ownership Act of 1988 to require that creditors give business applicants notice of the right to a written statement of reasons for a credit denial, and to impose a record retention requirement for certain business credit applications. In 1991, the ECOA was amended by the Federal Deposit Insurance Corporation Improvement Act to provide applicants with the right to obtain a copy of any appraisal Report used in connection with an application for credit to be secured by residential real property.

The amendments also established referral responsibilities on the part of the federal financial supervisory agencies (for referrals to the Department of Justice and the Department of Housing and Urban Development) for certain violations of the ECOA. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended the ECOA to create a privilege against disclosure for information developed by creditors as a result of "self-tests" they conduct.

ECOA is implemented by the Board of Governors of the Federal Reserve System's Regulation B[15]. In addition to a general prohibition against discrimination, the regulation

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[14] "The Attorney General's Annual Report to Congress pursuant to the Equal Credit Opportunity Act Amendments of 1976".
[15] FEDERAL RESERVE SYSTEM, 12 CFR Part 202 (Regulation B)

contains specific rules concerning the application and evaluation of credit applications, how credit history information is reported on accounts used by spouses, procedures and notices for credit denials and other adverse action, and limitations on requiring signatures of persons other than the applicant on credit documents.

A2. Fair Housing Act

The Fair Housing Act was enacted by Congress in 1968. It prohibits discrimination by direct providers of housing, such as landlords and real estate companies as well as other entities, such as municipalities, banks or other lending institutions and homeowners insurance companies whose discriminatory practices make housing unavailable to persons because of:

- race or color
- religion
- sex
- national origin
- familial status
- disability

Appendix

In cases involving discrimination in mortgage loans or home improvement loans, the United States Department of Justice may file suit under both the Fair Housing Act and the Equal Credit Opportunity Act.

Under the Fair Housing Act, the Department of Justice may file a lawsuit when there is reason to believe that a person has engaged in a "pattern or practice" of discrimination or has engaged in discrimination against a group of persons that raises an issue of "general public importance." Often, the Department's lawsuits allege that a defendant has done both[16].

The Fair Housing Act also provides procedures for handling individual complaints of discrimination. On the other hand an individual may file a complaint with the Department of Housing and Urban Development (HUD) or file their own lawsuit in federal or state court if there is an illegal housing practice.

HUD investigates each complaint, and if the complaint cannot be resolved through a conciliation process, HUD will determine whether there is reasonable cause to believe that the Fair Housing Act has been violated. When HUD makes this determination, it issues a written Determination of Reasonable Cause or No Reasonable Cause. If reasonable cause is found, HUD also prepares a Charge of Discrimination.

Within 20 days of the issuance of the charge, the complainant or the respondent (the party alleged to have discriminated) may choose to have the charge tried in federal court, otherwise the charge is tried in a HUD administrative law court[17].

A3. Truth in Lending Act

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[16] U.S. Department of Justice, Civil Rights Division, Housing and Civil Enforcement Section, 2000.
[17] U.S. Department of Justice, Civil Rights Division, Housing and Civil Enforcement Section, 2000.

The Truth in Lending Act was originally enacted by Congress in 1968 as a part of the Consumer Protection Act. The law is designed to protect consumers in credit transactions by requiring clear disclosure of key terms of the lending arrangement and all costs.

The law has been implemented by the Federal Reserve Board through two key regulations Z and M. Regulation Z explains how to comply with the consumer credit parts of the law, whereas Regulation M deals with consumer leasing transactions.

Regulation Z applies to each individual or business that offers or extends consumer credit if four conditions are met:

- The credit is offered to consumers
- Credit is offered on a regular basis
- The credit is subject to a finance charge (i.e. interest) or must be paid in more than four installments according to a written agreement
- The credit is primarily for personal, family or household purposes.

Regulation Z requires that creditors offering adjustable rate mortgage loans make available to consumers the booklet of Federal Reserve Board and the Federal Home Loan Bank Board entitled "Consumer Handbook on Adjustable Rate Mortgages " in order to help consumers understand the purpose and uses of adjustable rate mortgage loans.

Appendix
In addition to the Federal Reserve Board, the Department of Housing and Urban Development, the Federal Home Loan Bank Board and the National Credit Union Administration are also involved in the enforcement of the Truth in Lending Act. The Truth in Lending Act is designed to reduce confusion among consumers resulting from the different methods of computing interest. It does not require creditors to calculate their credit charges in any particular way. However, whatever alternative they use, they must disclose certain basic information so that the consumer can understand exactly what the credit costs are.

Paper

Under Regulation Z, disclosure must be made of the following important credit terms:

- Finance Charge - This is perhaps the most important disclosure made. This is the amount charged to the consumer for the credit.
- Annual Percentage Rate - This is the measure of the cost of the credit which must be disclosed on a yearly basis. The method for calculating this rate is determined by the underlying transaction.
- Amount Financed - This is the amount that is being borrowed in a consumer loan transaction, or the amount of the sale price in a credit sale.
- Total of Payments - This includes the total amount of the periodic payments by the borrower/buyer.
- Total Sales Price - This is the total cost of the purchase on credit, including the down payment and periodic payments.

Evidence of compliance with the Truth in Lending requirements must be retained for at least two years after the date of disclosure. Disclosures must be clear and must appear on a document that the consumer may keep.

A4. Home Mortgage Disclosure Act

The Home Mortgage Disclosure Act (HMDA) was enacted by the Congress in 1975 and is implemented by the Federal Reserve Board's Regulation C.

HMDA grew out of public concern over credit shortages in certain urban neighborhoods. Thus, one purpose of HMDA and Regulation C is to provide the public with information that will help show whether financial institutions are serving the housing credit needs of their neighborhoods and communities. A second purpose is to aid public officials in targeting public investments from the private sector to areas where they are needed.

Appendix

The period of 1988 through 1992 saw substantial changes to HMDA. Especially significant were the amendments to the Act in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Coverage was expanded in the FIRREA amendments to include many independent non-depository mortgage lenders, in addition to the previously covered banks, savings associations, and credit unions. Coverage of independent mortgage bankers was further expanded in 1993, with the implementation of amendments in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

Finally, the FIRREA amendments of 1989 require the collection and disclosure of data about applicant and borrower characteristics to assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

HMDA is a disclosure law that relies upon public scrutiny for its effectiveness. Financial institutions must report data regarding loan originations, applications, and loan purchases, as well as requests under a pre-approval program, if the pre-approval request is denied or results in the origination of a home purchase loan. HMDA requires lenders to report the ethnicity, race, gender, and gross income of mortgage applicants and borrowers.

Lenders must also report information regarding the pricing of the loan and whether the loan is subject to the Home Ownership and Equity Protection Act. Additionally, lenders must identify the type of purchaser for mortgage loans that they sell.

A5. The Real Estate Settlement Procedures Act

The Real Estate Settlement Procedures Act (RESPA) is a consumer protection statute, enacted by Congress in 1974. The purposes of RESPA are to help consumers become better shoppers for settlement services, and to eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services.

1. RESPA Disclosures

RESPA requires that borrowers receive disclosures at various times. Some disclosures spell out the costs associated with the settlement, outline lender servicing and escrow account practices and describe business relationships between settlement service providers. RESPA requires the following disclosures at the time of loan application, before settlement/closing occurs, disclosures at settlement, and after settlement:

- **Disclosures at the Time of Loan Application**

When borrowers apply for a mortgage loan, mortgage brokers and/or lenders must give the borrowers:

- a Special Information Booklet, which contains consumer information regarding various real estate settlement services.
- a Good Faith Estimate (GFE) of settlement costs, which lists the charges the buyer is likely to pay at settlement.
- a Mortgage Servicing Disclosure Statement, which discloses to the borrower whether the lender intends to service the loan or transfer it to another lender. It also provides information about complaint resolution.

If the borrowers do not get these documents at the time of application, the lender must mail them within three business days of receiving the loan application.

- **Disclosures before Settlement**

An Affiliated Business Arrangement (AfBA) Disclosure is required whenever a settlement service provider involved in a RESPA covered transaction refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest.

Appendix

The referring party must give the AfBA disclosure to the consumer at or prior to the time of referral. The disclosure must describe the business arrangement that exists between the two providers and give the borrower an estimate of the second provider's charges.

RESPA allows the borrower to request to see the HUD-1 Settlement Statement one day before the actual settlement. The HUD-1 Settlement Statement is a standard form that clearly shows all charges imposed on borrowers and sellers in connection with the settlement.

- **Disclosures at Settlement**

The HUD-1 Settlement Statement shows the actual settlement costs of the loan transaction. Separate forms may be prepared for the borrower and the seller. Where it is not the practice that the borrower and the seller both attend the settlement, the HUD-1 should be mailed or delivered as soon as practicable after settlement.

The Initial Escrow Statement itemizes the estimated taxes, insurance premiums and other charges anticipated to be paid from the escrow account during the first twelve months of the loan. It lists the escrow payment amount and any required cushion. Although the statement is usually given at settlement, the lender has 45 days from settlement to deliver it.

- **Disclosures after Settlement**

Loan servicers must deliver to borrowers an Annual Escrow Statement once a year. The annual escrow account statement summarizes all escrow account deposits and payments during the servicer's twelve month computation year. It also notifies the borrower of any shortages or surpluses in the account and advises the borrower about the course of action being taken.

A Servicing Transfer Statement is required if the loan servicer sells or assigns the servicing rights to a borrower's loan to another loan servicer. Generally, the loan servicer must notify the borrower 15 days before the effective date of the loan transfer. As long the borrower makes a timely payment to the old servicer within 60 days of the loan transfer, the borrower cannot be penalized. The notice must include the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments.

2. Consumer Protection and Prohibited Practices

RESPA also prohibits certain practices that increase the cost of settlement services.

- **Kickbacks, fee-splitting, unearned fees**

RESPA prohibits anyone from giving or accepting a fee, kickback or any thing of value in exchange for referrals of settlement service business involving a federally related mortgage loan. In addition, RESPA prohibits fee splitting and receiving unearned fees for services not actually performed.

- **Seller required title insurance**

RESPA prohibits a seller from requiring the home buyer to use a particular title insurance company, either directly or indirectly, as a condition of sale.

- **Limits on escrow accounts**

RESPA sets limits on the amounts that a lender may require a borrower to put into an escrow account for purposes of paying taxes, hazard insurance and other charges related to the property.

B. Regulation of Borrower Protection in European Union

B1. The Code of Conduct for Home Loans

The information disclosure for mortgage loans in the European Union is regulated by the European Code of Conduct for Home Loans (Code of Conduct). The European Code of Conduct is a voluntary initiative, which was coordinated by the European Mortgage Federation together with other European Credit Sector Associations, representatives of consumer bodies and officials at the European Commission. The Code of Conduct officially came into effect on September 30, 2002.

The aim of the Code was to make it easier for consumers to compare loan products available from different lenders, including lenders from another Member State, and so allow consumers to make an informed choice[18].

Discussions on a possible European Code of Conduct began in 1996, triggered by the European Commission's 1996 Green Paper and Communication on financial services, together with the preference for a dialogue between lenders and consumers and a self-regulatory approach as opposed to a less flexible approach by a European Commission Directive.

[18] European Community of Consumer Cooperatives, "Monitoring the Update & Effectiveness of the Voluntary Code of Conduct on Pre-contractual Information for Home Loans", 2004.

The UK Mortgage Code was taken as the starting point for discussion on a European version. The European Code of Conduct is based on the UK's Mortgage Code, but does not apply to mortgage intermediaries and does not cover the provision of mortgage advice. Rather, it concentrates on the amount and quality of pre-contractual information given to consumers.

The object of the Code is to improve and standardize consumer information and help prospective borrower choose the mortgage loan which is in their best interests. By standardizing the information the Code is intended to help develop cross-border mortgage transactions and boost competition.

The Code covers consumer information for domestic and cross-border home loans. According to the Code a "home loan" is a credit to a consumer for the purchase of the private immovable property he owns or aims to acquire, secured either by a mortgage on immovable property or by a surety commonly used in a Member State for that purpose. This definition of "home loans" according to the Code of Conduct does not include loans for commercial purposes.

The approach for regulating the pre-contractual information on home loans was through self-regulation instead of regulatory approach. According to the Agreement[19] must monitor the uptake and effectiveness of the Code. The Industry Progress Report prepared by the European Commission concluded that the results at the end of 2002 were satisfactory[20] and was based on Reports of National Associations which are members of the Signatories to Agreement on the Code of Conduct for Home Loans.

The Code of Conduct's main purpose is to improve and standardize pre-contractual consumer information. In particular, credit institutions subscribing to the Code are obliged to provide to consumers[21]:

- General information on home loans offered; and
- Personalized information at a pre-contractual stage via a "European Standardized Information Sheet".

Both sets of information are compulsory, however, the first one is not standardized whereas the second it is standardized. The European Commission is responsible for monitoring implementation of the Code[22].

1. General information about home loans offered

According to the Code, the initial information about home loans should include or be accompanied by the following information:

A – Lender:

1. Identification and address of the lender;
2. Where appropriate, identification and address of the intermediary.

[19] European Agreement on a Voluntary Code of Conduct for Pre-Contractual Information on Home Loans.
[20] European Mortgage Federation Annual Report 2004.
[21] Institute for Financial Services E.V. "Monitoring the uptake and the effectiveness of the Voluntary Code of Conduct on Pre-contractual Information for Home Loans", 2003.
[22] European Community of Consumer Cooperatives, "Monitoring the Update & Effectiveness of the Voluntary Code of Conduct on Pre-contractual Information for Home Loans", 2004.

B - Home Loan:

1. Purposes for which the home loan may be used;
2. Form of surety;
3. Description of the types of home loans available with short description of the differences between fixed and variable rate products, including related implications for the consumer;
4. Types of interest rate - fixed, variable, combinations thereof;
5. An indication of the cost of a typical home loan for the consumer;
6. A list of related cost elements, such as, administrative costs, insurance costs, legal costs, intermediaries' costs;
7. The different options available for reimbursing the credit to the lender (including the number, frequency, amount of repayment installments if any);
8. Whether there is a possibility of early repayment (if so, its conditions);
9. Whether a valuation of the property is necessary and, if so, by whom it has to be carried out;
10. General information on tax relief on home loan interest or other public subsidies prevailing, or information on where one can obtain further advice;
11. The duration of the reflection period, where relevant;
12. Confirmation that the institution subscribes to the Code, and indication that a copy of the Code is available at the institution.

2. Personalized information at a pre-contractual stage to be presented in a "European Standardized Information Sheet"

The European Standardized Information Sheet (ESIS) is a list of the main price elements of the offer that are considered essential. In fact, the ESIS is a summary of the mortgage. It is mainly focused on cost elements. It is intended to be given once the lender knows about the personal circumstances of the consumer and will therefore be personalized to the consumer’s individual situation and needs.

The 15 items of information, must be given in a standardized format. The information includes a description of the product, the interest rate (nominal and Annual Percentage Rate of Charge), the type of interest and rule on variation, the amount of credit, the duration, the repayment scheme, the possibility of early repayment and conditions, the reference for the complaint scheme and illustrative amortization table.

The ESIS is the key achievement of the Code since it results in a harmonization of information to be given to consumers in the housing credit area and constitutes a concrete means of comparison of loan offers.

It is important to note that the ESIS is an informational document; it is not an offer and is therefore not binding.

3. Implementation

The procedure for implementation of the Code starts with a two-step procedure and a set timeframe:

Registration: Credit institutions, which decide to adhere, must first signal their intention to do so by registering in the specific Code of Conduct Register created and managed by the European Commission.

Implementation: Credit institutions, which have registered with the European Commission, have one year from the date of registration to effectively implement the Code.

At the end of 2002, over 3600 credit institutions from 14 Member States[23] and Norway signaled their adherence to the Code by registering in the Commission's Register. In general the registration coverage throughout the Member States is impressive. In 7 Member States the industry made a collective registration. This was made by the national trade association(s) and therefore covers the near totality of the mortgage lending sector, amounting to 95% to 100% of the national market. In the other Member States, registration has occurred on an individual basis, which also amounts to a very high percentage of national markets[24].

The average level of registration throughout the above listed member States is 90 to 95%. The main exception, however, is France, where the current level of registration (30%) is expected to reach 50 to 55% shortly. Most French credit institutions have not adhered to the Code yet due to incompatibilities with national legislation. Spain is the only country, where credit institutions have not registered yet. The reason for the delay in Spain is related to a problem of incompatibility between national legislation and the European Code of Conduct.

B2. Consumer Credit

The Maastricht treaty (the Treaty on European Union) moved consumer policy higher up the European agenda. In 1996, the European Commission commissioned a study that examined whether the 1987 consumer credit directive could be applied to mortgage credit. The study concluded that in most Member States, consumer protection standards for mortgage lending "meet or exceed the minimal requirements of the Consumer Credit Directive."

The consumer protection situation in European Union varies greatly from country to country. France, Spain, Belgium, Ireland, and Sweden have enacted strict consumer protection regulations. Germany, Denmark, Sweden, Austria, and the UK have adopted regulations concerning specialized lenders. Germany and Austria have strict product regulations. Denmark and the Netherlands have adopted mortgage codes. It seems that it would be difficult to find agreement on how to harmonize mortgage credit, and also that minimum harmonization would not help create a single mortgage market.

The European Commission adopted its proposal for a revised Consumer Credit Directive in 2002. This adoption was preceded by the issuance of a general consultation paper. Finally, it should be noted that the European Parliament in its First Reading of the Consumer Credit Directive proposal, excluded secured mortgages from this Directive in order to ensure that mortgages are not subject of two separate mortgage regimes[25].

B3. Proposal Directive on Unfair Commercial Practices

In 2003, the European Commission adopted the proposal for a Directive on Unfair Commercial Practices. The Directive aims to achieve a high level of consumer

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[23] Belgium, Denmark, Germany, Greece, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden, The United Kingdom.
[24] European Mortgage Federation Annual Report 2004.
[25] Forum Group on Mortgage Credit Report, "The integration of the European Union Mortgage Markets", 2004.

protection and improve the functioning of European markets be enforcing legal certainty in cross-border trade.

The Directive establishes rules for determining whether a commercial practice is unfair and aims to define a limited range of “sharp practices”, which are prohibited throughout the European Union. It includes a “general clause” or “general prohibition”, which lays down two general conditions to determine whether a practice is unfair[26]:

- The practice is contrary to the requirement of professional diligence;
- The practice materially distorts consumer’s behavior.

The Directive defines and bans misleading and aggressive practices. Two main categories of unfair business-to-consumer commercial practices are also defined in more detail: misleading and aggressive practices.

According to the Directive, a commercial practice may be considered “misleading” either as a result of action or the omission of “material” information, which the average consumer needs to make an informed decision.

In terms of “aggressive” practices, the Directive specifies three ways in which a commercial practice may be considered as such: harassment, coercion, and undue influence.

C. US and EU Approaches to Borrower Protection

C1. Similarities in Borrower Protection

A brief comparison between consumer policies in the US and EU would establish several similarities. The proposed European Directive on unfair commercial practices will enshrine in EU consumer protection principles that are consistent with US laws[27]. Consumer policy development is shared with member states in the European Union and states in the United States.

C2. Different Approaches

However, there are three main different approaches between the EU and US approach to consumer protection[28].

- Enforcement is within the power of US executive federal agencies such as the Federal Reserve Board or the United States Department of Housing Development. In the European Union, it is mainly done by the Member States.

- Direct action by individual or groups of consumers seeking redress through the legal system, notably through class actions, plays a role in the United States but not in the European Union.

[26] European Mortgage Federation Annual Report, 2004
[27] David Byrne, European Commissioner for Health and Consumer Protection, “Europe place in the World: the consumer perspective” 2004.
[28] David Byrne, European Commissioner for Health and Consumer Protection, “Europe place in the World: the consumer perspective” 2004.

- EU consumer NGOs are mainly national bodies, general in their sphere of interests, addressing a wide-range of consumer interests. US consumer organizations are typically bigger, but they are also more specialized.

V. RECOMMENDATIONS

The principal recommendations are divided into the following categories:

A. Standardized Information Form

In the area of borrower information and product transparency, the creation of a standardized information form is a true alternative to a legal regulation regime. The standardized information form will be provided to the borrower at the advertising stage voluntarily by the mortgage lender.

The standardized information form could include, but not be limited to, the following: administration or handling charges, any other charges involved, total amount borrowed and payable (including installment amount, calculation and operation of installments), form of product, the cost of the early repayment fee (including worked examples of the charge).

The drafting of the standardized information form and the voluntary implementation by the mortgage lenders would create a unified minimum standard in Egypt for borrower information and product transparency.

The voluntarily implementation of the standardized information form can be accomplished through the Egyptian Mortgage Association in cooperation with the Mortgage Finance Authority and mortgage finance companies without adopting new legislation. A register can be held within the Egyptian Mortgage Association where the mortgage finance companies can register and sign to voluntarily implement the standardized information form.

B. Borrower Protection Legislation

It is recommended to draft the necessary legislation and forms to regulate standardized borrower protection. The objective of the new legislation should be to introduce transparency and consistency in the provision of information to borrowers by lenders about mortgage credit offers. Furthermore, the goal of the new borrower protection legislation should be to help borrowers eliminate unnecessary fees, to protect borrowers especially women and the poor against lender's discrimination, and to provide standardized borrower protection during the mortgage process.

C. Education and Awareness on Borrower Standardized Protection

It is recommended to: raise awareness among the major stakeholders (e.g., government, bank managers and owners, regulatory authorities, and the general public) about the need for borrower protection legislation and the type of support each stakeholder will provide to this initiative; undertake educational programs (e.g., seminars or workshops) to raise the awareness of government, lenders, and consumers of the benefits of borrower standardized protection; and encourage key Egyptian participants to attend outside gatherings on borrower protection and related mortgage loans information topics.

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25. FEDERAL RESERVE SYSTEM, 12 Code of Federal Regulations Part 202 (Regulation B).
26. FEDERAL RESERVE SYSTEM, 12 Code of Federal Regulations Part 226 (Regulation Z).
27. FEDERAL RESERVE SYSTEM, 12 Code of Federal Regulations Part 213 (Regulation M).
28. Malaysia Consumer Protection Law, 1999.
29. Capital and Interest, Eugen von Böhm-Bawerk, 1890.