EBA/CP/2013/46: Draft Regulatory Technical Standards

On the minimum monetary amount of the professional indemnity insurance or comparable guarantee for mortgage credit intermediaries under Article 29(2)(a) of the Directive on credit agreements relating to residential immovable property (Directive 2014/17/EU)

Submission from the Banking Stakeholder Group

In Article 29(2)(a) of the above mentioned Directive, the EBA is mandated to develop draft regulatory technical standards (RTS) to stipulate the minimum monetary amount of the professional indemnity insurance or comparable guarantee for mortgage credit intermediaries.

The Banking Stakeholder Group (BSG) welcomes the proposed draft regulatory technical standards and appreciates the work carried out by the EBA to fulfill its mandate. However, we consider that the subject of indemnity insurance should not be the responsibility of the EBA, but rather EIOPA as the more appropriate European Supervision Authority responsible for setting the level of the minimum monetary amount of the professional indemnity insurance.

BSG considers the current EBA mandate under the Mortgage Credit Directive does not appropriately reflect the complexity of the task of effectively constructing PII as a regulatory tool aiming at providing European consumers with an adequate and effective protection regime. BSG finds it challenging from the proportionality principle perspective to set the appropriate level of consumer protection by reduction to setting minimum monetary amount of PII. The mandate for EBA should be broader and should also focus on an effective level of protection provided to customers by PII in cases where something goes wrong. The mandate should also deal with qualitative elements of PII such as: the level of excess/deductible, the issue of exclusions, whether PII claims made by customers should be admitted in cases where a mortgage intermediary is bankrupted or otherwise goes out of business, and what the minimum time period should be for such claims made by customers. There is also the question of whether PII should cover gross negligence and fraudulent conduct at least in certain instances - this requirement could be seen as rationally expected by consumers when being informed that an intermediary has obtained PII. A further issue is the way that insurance claims are handled and processed e.g. whether consumers should sue the mortgage intermediary for any damages (a process which may take years) prior to the insurance provider being obliged to pay out the indemnity, and the issue of whether the consumer should bear the costs for court proceeding in such case .

Given the complexity of the issues involved, BSG considers that there must be close cooperation between EBA and EIOPA in the setting of standards regarding PII for mortgage intermediaries where PII serves as a regulatory tool aiming at providing European consumers with adequate and effective protection. This is a general comment in respect of any use of PII or any other insurance product for enhancement of consumer protection.

In order to fulfill its mandate, the EBA carried out desk research, and surveyed competent authorities in each of the 28 EU Member States. The EBA received 22 responses from the competent authorities. This limited number of responses from the survey revealed that PII is mandatory in only seven Member States: Austria, France, Italy, the Netherlands, Slovakia, Spain and the United Kingdom.

However, taking into account the responses from these seven jurisdictions, the EBA survey found that the details of the regulatory requirements differed widely between them:

- two Member States apply the minimum amount to yearly coverage only, while five Member States distinguish between a minimum amount per year and per claim;
- the minimum amount per claim ranges between EUR 100 000 and EUR 1 120 200 and the minimum amount per year varies between EUR 150 000 and EUR 1 750 000;

- the minimum amount is multi-tiered in four jurisdictions, where it is related to the turnover of the intermediary, whereas three Member States have a single-tiered approach, i.e. one amount applicable to all intermediaries;
- the minimum amount in two jurisdictions is derived from the Insurance Mediation Directive, whereas in the others it is not.

The BSG is aware of the challenging position of EBA in meeting its mandate in particular given the lack of relevant data and the diversity of approaches across jurisdictions. The BSG strongly supports the EBA proposal in section 4.6 of the Consultation Paper to introduce the principle of proportionality in the determination of the level of PII coverage for mortgage intermediaries which are in certain jurisdictions currently not subject to regulation. The application of the proportionality principle in respect of any proposed regulatory measure should always be a key measure to assess the benefits/cost of such regulation. In that respect the effort of EBA staff articulated in section 4.6 of the Consultation Paper is strongly supported.

BSG members suggest two alternative options.

BSG OPTION 1

The first option which the BSG considers is in line with one of the four options outlined in the EBA Consultation Paper. Taking into account:
- the lack of historical claims data (which were available in only one of the seven Member States, which is insufficiently representative);
- the lack of the concrete level of the insurance premiums paid by mortgage credit intermediaries;
- the diversity of approaches across the jurisdictions,

the BSG is of the opinion that Option 4 in the EBA's paper – setting the minimum amount at the average of the amounts used in those Member States that already require PII for mortgage credit intermediaries - is the most suitable option at the moment. However, we regard this as only an interim solution as is envisaged in the Consultation Paper.

The BSG questions the appropriateness of applying the average amount in this context. The BSG considers that it is not methodologically robust to use a simple average of the responses received. This is because, taking into account the results of the most recent study on credit intermediaries, which is mentioned by EBA in the Consultation Paper[1], there are huge differences between the seven mentioned Member States in terms of the number of intermediaries, number of employees, volume of mortgage credit, etc.

We would propose a weighted average approach, based on the reality presented in the above-mentioned study, because it would better reflect the reality of the EU market. Regarding the specific weights, we propose the use of the weights resulting from the above-mentioned study [table 5.2, page 95], taking into account the last column figures per Member State and per total (see also Annex 1 below).

Applying this methodology, the resultant minimum amounts would be EUR 343 000 per claim (instead of EUR 584 000 per claim) and EUR 778 000 per year (instead of EUR 886 000 per year).

Considering that:

- the above levels of minimum amounts were calculated taking into account the minimum levels in the jurisdictions where there are multiple levels (Italy, Spain, UK);
- the BSG does not want to see a significant reduction of the degree of consumer protection in some Member States (Austria, the Netherlands, France and Italy);
- the BSG is a strong supporter of the proportionality principle,

we propose that the above levels be applied only to “small mortgage credit intermediaries”.

In our opinion, and derived from the mentioned study (see also the Annex below), a small mortgage credit intermediary is an intermediary which is a “natural person” or a “legal person” with not more than 10 employees, five branches or premises, 700 customers per year, turnover of EUR 700 000 per year (cumulative condition). The

[1] European Commission (2009), Study on Credit Intermediaries in the Internal Market

proposed numbers (except branches, which were not available) are significantly above the average figures resulted from the calculation.

All other mortgage credit intermediaries (those with at least one of their numbers larger than mentioned above) should be required to have the same minimum amount per claim, but a minimum amount per year which is double than that of small mortgage credit intermediaries – EUR 1 556 000. In this way, we would argue that our proposal is balanced, considering an acceptable degree of consumer protection and also possible compliance costs for mortgage credit intermediaries.

We would also like to draw the EBA's attention to the fact that its calculation of a simple average contains some errors. For instance, Italy was not taken into account in calculating the average amount per claim, and the 1 GBP was calculated on the basis of 1 EUR, and not 1.2 EUR as it really was.

BSG OPTION 2

The second option discussed by BSG elaborates on section 4.6 of the EBA Consultation Paper. Firstly, for the determination of the appropriate level of a minimum monetary amount of PII, key risk factors contributing to the risk profile of a mortgage intermediary should be taken into account. Given the specific nature of its activity (where risks are inherently linked to human failure) it seems that: (i) the number of agents or employees, (ii) the number of clients, and (iii) the volume of mortgage credits intermediated, are likely to be key risk factors. Regarding agents/employees contribution to the mortgage intermediary risk profile, it may be relevant also to consider the level of education and professional training and length of practical experience in the respective field as risk mitigating factors.

BSG appreciates, and in general supports, the over-arching aim of establishing a harmonized regime for intermediation of mortgage credit. However, in the light of the proportionality principle, BSG believes there are sound arguments to take into account certain market/country specific factors as well. For example, the average size of the mortgage credit intermediated in the relevant market in the Member State in which the mortgage intermediary is active. These criteria could roughly reflect the situation in the relevant market as well as the structure of the intermediaries' clients in that Member State.

In respect of setting the level of PII coverage rightly balancing and proportionately respecting interests of consumers as well as costs to intermediaries, the key question is what level of protection should be provided to a consumer? Given the non-homogenous situation in the markets in individual Member States, it could be considered to set the harmonized level of consumer protection in relative terms such as the percentage or better multiple of factors characteristic of the respective market such as, for example, the average size of consumer mortgage credit. This approach would mean full harmonisation in the method of the determination of the level of customer protection while also enabling proportionality in respect of different types of intermediaries and diverse markets. Setting the appropriate level of protection is undoubtedly a complex issue. However in the current market and regulatory environment, and given the lack of data available to EBA, this must remain a matter of judgement.

In light of section 4.6 of the Consultation Paper, and various factors mentioned by the EBA and other stakeholders involved in the preparation of the Consultation Paper, it could be suggested to EBA to devise a simple formula for the determination of appropriate levels of PII coverage for individual mortgage intermediary active in particular markets in the European Union instead of setting a single number of PII coverage.

Also, changes in the market and other developments should be taken into account - the formula for calculation of the level of PII coverage should reflect this and, for example, could be annually re-calculated for individual mortgage intermediaries.

How might such a formula be composed? The formula should be simple and clear. It could be envisaged that the formula be composed of three basic elements:

i) A Basic Level of PII coverage (reflecting the relevant market the intermediary is active in)

Plus

ii) Certain add-ons (representing "specific" risks in respect of an individual intermediary)

Minus

iii) Certain deductions (representing "specific" risk mitigation factors in respect of individual intermediaries)

Explanation of the model formula:[2]

Ad i) The Basic Level of PII coverage could be envisaged as a multiple of the average mortgage credit provided in the relevant market in the preceding year ("Average Mortgage") - for example a multiple of 5;

Ad ii) Add-ons could be represented by the following factors:

(a) Actual number of agents/employees of the mortgage intermediary (for example 5 % of the Average Mortgage per single agent/employee);

(b) Annual volume of credit intermediated by the mortgage intermediary in the preceding year (for example 0.5 % of the Average Mortgage per volume of mortgage credit intermediated by the mortgage intermediary equivalent to the Average Mortgage);

(c) Number of clients of the mortgage intermediary in the preceding year (for example 0.5 % of the average mortgage credit in the relevant market per single client);

Ad iii) Reductions could be represented by the following factors

(a) Level of education of individual agent/employee (for example 1% of the Average Mortgage for a university degree);

(b) Level of professional training of individual agents/employees (for example 1 % of the Average Mortgage per recognised professional training passed in the last three years);

(c) Level of professional experience (for example 0.5 % of the Average Mortgage per every three years of professional experience in the mortgage sector).

Model calculation of the level of PII cover

[2] Specific weights attributed to individual factors below are intended for demonstrational purposes only.

Assume a mortgage intermediary active in the market where the average mortgage credit provided in a relevant market in the preceding year was 100.000 EUR. Other factors according to the formula are:

- Actual number of agents/employees of the mortgage intermediary - [10]
- Annual volume of credit intermediated by the mortgage intermediary in the preceding year - [20.000.000 EUR = i.e. 200 x 100.000 EUR]
- Number of clients of the mortgage intermediary in the preceding year - [150]
- Number of agents with university degrees [5]
- Number of agents who passed recognised professional training in the last three years [5]
- Agents who have more than three years of professional experience in the mortgage sector [5] and agents who have more than six years of professional experience in the mortgage sector [5]

Calculation based on model case:

Ad i) Basic level of PII coverage

5 x 100.000 EUR = 500.000 EUR

Plus

Ad ii) Add-ons

10 x 5% x 100.000 EUR = 50.000 EUR

200 x 0.5% x 100.000 EUR = 100.000 EUR

150 x 0.5% x 100.000 EUR = 75.000 EUR

[Total Add-ons 225.000 EUR]

Minus ad iii) Deductions]

5 x 1% x 100.000 EUR = 5.000 EUR

5 x 1% x 100.000 EUR = 5.000 EUR

5 x 0.5% x 100.000 EUR = 2.500 EUR

5 x 1% x 100.000 EUR = 5.000 EUR

[total deductions 17.500 EUR]

Total level of PII coverage for model mortgage intermediary is 707.500 EUR.

Feasibility of the formula approach

Although this approach of establishing a harmonised formula may be viewed as somewhat complex, its advantage is that it enables a proportionate accommodation to respective market and conditions of individual credit intermediaries while at the same time providing an appropriate level of consumer protection in that market. The data necessary for the calculations are of a type which tend to be subject of regular reporting by intermediaries in other sectors of the financial market which are already regulated (such as investment and insurance intermediaries in a number of Member States).

In practice, most mortgage intermediaries have already obtained some form of PII. From the time perspective, PII is negotiated for limited periods of time most often for a year with possible variation in PII coverage, premiums paid, and the setting of the minimum level of PII coverage. This process does not, therefore, represent anything completely unknown either to insurance companies or intermediaries.

From this general perspective there will be some additional administrative burden arising from the introduction of this mandatory system which should be compensated by setting the appropriate level of consumer protection. However, given the cost of the premium for PII providing effective coverage to consumers (as reference in section I. above) to be paid by insurance intermediaries, it is the proportionality principle that should be the key over-riding concept behind setting the level of the monetary amount of PII coverage for mortgage intermediaries.

ANNEX

Extras from Tables 5.2, 5.4 and 5.5 - Intermediaries in the retail of mortgages (EC Study - 2009), EBA CP table (page 19)											
Member State	Intermediary share	Mortgage Volumes 000s	Revenues from mortgage intermediation (estimates, average) mil.	Number of credit intermediaries	Number of employees (estimates, average)	Minimum level per claim (EUR) EBA CP page 19	Minimum level per year (EUR) EBA CP page 19	Weight of mortgage volumes per total EU market (%)	Number of employees per intermediary (average)	Revenues per intermediary (average) 000s	Number of mortgages/ customers per intermediary (average)
Austria	35%	14	17	100	200	1111675	1677513	0,40	2	170	140
France	22.5%	330	380	600	2800	500000	800000	9,52	4,67	633	550
Italy	25%	193	271	1100	3400	500000	1000000	5,57	3,09	246	175
the Netherlands	45%	346	458	1400	5600	1120200	1680300	9,98	4	327	247
Slovakia	20%	15	31	0	100	100000	150000	0,43	NA	NA	NA
Spain	20%	163	313	800	3900	NA	300000	4,70	4,88	391	204
the United Kingdom	70%	1605	3000	7100	31700	120000	600000	46,28	4,46	423	226
Total 27 MS	average 41.5%	3468	5216	13300	56000	NA	NA	100	4,21	392	261
				Minimum proposed amount		343089	778702	Proposed	10	700	700

Submitted on behalf of the Banking Stakeholder Group

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Chair

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