



BANKING STAKEHOLDER GROUP

CONSULTATION ON EBA/CP/2014/43 ON
“DRAFT GUIDELINES ON ARREARS AND FORECLOSURE”

General Comments and Replies to Questions

BY THE EBA BANKING STAKEHOLDER GROUP

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Foreword¹

The EBA Banking Stakeholder Group (“BSG”) welcomes the opportunity to comment on the Consultation Paper 2014/43 on Draft Guidelines on arrears and foreclosure.

This response has been prepared on the basis of comments circulated and shared among the BSG members and the BSG’s Technical Working Group on Consumer Issues and Financial Innovation.

Article 28 of the Mortgage Credit Directive (MCD) sets out provisions in the area of arrears and foreclosure, and specifically requires that Member States shall adopt measures to encourage creditors to exercise reasonable forbearance before foreclosure proceedings are initiated.

In order to ensure that these high-level provisions will be implemented and supervised consistently across the 28 EU Member States, and to support the transposition of the MCD, the EBA is issuing and consulting on draft Guidelines.

The Guidelines provide detail on how financial institutions should give effect to the relevant MCD provisions in Article 28, and thus contribute to the EBA’s objective of achieving a convergence of supervisory practices for the Directives that fall within the EBA’s scope of action. The Guidelines establish requirements on policies and procedures; engagement with the consumer; provision of information and assistance to the consumer; the process; and documentation of dealings with the consumer and retention of records.

This response outlines some general comments by the BSG, as well as our detailed answers to the questions indicated in the Consultation Paper.

General comments

The guidelines have the merit of setting out the minimum requirements and measures to be implemented by creditors. However, they are written in a high level of generality with very few detailed requirements, especially when compared with the codes adopted by some national authorities (see, for instance, Portugal, UK, and Ireland).

As a very important principle, the BSG considers that it is essential that the mechanisms created to deal with arrears and foreclosure do not lead to a situation which is more unfavorable to the consumer compared with existing

¹ Discussions with members of the Financial Services User Group (FSUG) are gratefully acknowledged.

codes established by Member States. On the contrary, the BSG asks the EBA to introduce as many solutions as possible to make sure that consumers are protected in a very efficient way.

For this reason, the BSG is supporting the EBA option for the conversion of the practices of the current EBA Opinion relevant to Art. 28 MCD into Guidelines and the revision of the remaining parts of that Opinion.

Replies to Questions

1. Do you agree with the proposed Guidelines? If not, outline why you disagree and how the Guidelines could be improved. Please respond separately for each of the five Guidelines.

The BSG generally agrees with the proposed guidelines, but has some comments, proposals and remarks which could contribute to a better form and substance of those guidelines.

1. Establishment of policies and procedures

1.1 The creditor should establish procedures to detect early indications of consumers going into payment difficulties.

1.2 The creditor should establish policies and procedures for the effective handling of and engagement with consumers in payment difficulties.

1.3 The creditor should provide adequate training for staff dealing with consumers in payment difficulties.

1.4 The creditor should review these policies and procedures regularly.

The BSG supports the above requirements, but considers that the Guidelines should go further.

As we are in a specific context of an extended period of historically low interest rates in all Member States, and because changes in exchange rates for loans in foreign currency are unpredictable from a borrower perspective (see the recent dramatic rise of Swiss franc), all creditors should be required both to take action to identify customers who are susceptible to arrears if interest rates/exchange rates rise, and have appropriate strategies to treat them fairly.

As mentioned in Article 23 (4) of the MCD, Member States shall ensure that, in case of credits in foreign currencies, the creditors warn the consumers on a

regular basis, but at least where the value of the total amount payable by the consumer which remains outstanding or of the regular instalments varies by more than 20% from what it would be if the exchange rate between the currency of the credit agreement and the currency of the Member State applicable at the time of the conclusion of the credit agreement were applied.

It should also be strictly forbidden to lend money to debtors in an irresponsible manner, which will make them over-indebted shortly after the signing of the credit agreement. For instance, it should be forbidden to lend money to consumers who clearly will not be able to afford the payments on a hypothetical adverse scenario - the so-called “subprime loans”.

This was unfortunately the case before the crisis in some Member States² where consumers were tempted with loans with relatively low fixed introductory or teaser interest rates for 3,6 or 12 months, and after this period the interest rate rose to very high levels (sometimes double or even more compare with the initial one). There have also been cases in which there was a limitation on the reduction in interest rates - as was the case with several hundreds of thousands of mortgages in Spain, through the famous “ground clauses”.

At the same time, debt-to-income ratios (calculated as a share of debt service in total disposable income) were sharply increased by banks up to 65%-70%. As a result, on a very short time, many consumers became over-indebted, without any realistic chance to service their debt in time. It was also the crisis that hit them soon, and their revenues decreased also, together with the prices of immovable properties (because it was asset bubbles before the crisis), which in some cases declined by 50% or even more.

We also draw attention to the fact that because in some cases the rate of interest for the local currency was very high compared with those on foreign currencies, the vast majority of the loans approved before the crisis³ were disbursed in foreign currencies. At the same time the exchange rates sharply increased⁴.

Taking into account these realities, all the procedures established to detect consumers in payment difficulties must be correlated with the way the credit was approved and disbursed.

Creditors should develop information relating to impairment and a performance tracking system to proactively segment their pre-arrears population. They should consider which borrowers are most likely to be affected by potential rate rises,

² For instance, Romania and other Central and Eastern European Member States

³ In Romania, the percent was about 70% of the total loans disbursed before the crisis

⁴ Comparing with the middle of year 2007, when was the best moment for RON, now (end of January 2015) the exchange rate has increased with about 250% for CHF/RON and with about 40% for EUR/RON.

for example, those who have experienced payment problems in the past or those with a high debt-to-income ratio. Creditors should consider deploying proactive strategies to engage them at the earliest moment possible.

Creditors should put in place tools to detect and act upon ‘early warning signs’ such as borrowers consolidating debt or failing to meet all of their financial commitments. This would allow them to develop effective early engagement strategies and offer proactive solutions or money advice which increase the chance of better outcomes for both customers and creditors.

BSG suggests establishing a common definition of alerts, designed in collaboration with consumer associations, which might provide for situations of risk of failure, as it exists in Portugal with the Action Plan for the Risk of Failure (PARI).

Senior management should have the duty to promote cultures in arrears management functions which focus on delivering outcomes aligned with the best interests of customers. Management need to provide leadership and direction to create an environment that enables their staff to make informed judgments, and take decisions that reflect the specific personal and financial circumstances of individual borrowers. Remuneration and reward schemes for frontline staff should incentivise them to make decisions based on the best interests of customers. If staff are incentivized according to the amount of money they recover from the borrower then they may have a focus on the short-term rather than considering other arrangements which would be in the best interests of customers and, possibly, also the creditors in the long run.

They must ensure that decisions around forbearance or repossession are suitable given the specific personal and financial circumstances of borrowers - dealing sensitively with borrowers who may have particular vulnerabilities. Decisions should take account of a borrower’s likely long-term ability to repay their arrears.

We also have suggestions for editing the proposed form of points 1.1-1.4.

At point 1.1, the following text should be added at the end of the sentence: *“and contact them immediately to provide financial advice and proper solutions quickly in order to prevent any potential damage to consumers”*.

At point 1.2, the following text should be added at the end of the sentence: *“... or expected payment difficulties, especially preventing the loss of the debtor’s residence”*.

We recommend creditors to contact consumer organisations in order to prepare the most suitable training for staff dealing with consumers in payment difficulties and even to involve representatives of consumer organisations in this process.

At point 1.3, the following text should be added at the end of the sentence: “...or expected payment difficulties. This training should take into consideration the recommendations made by consumer organisations”.

The BSG considers that the review of the policies and procedures should be done at least yearly and suggests including this at the end of point 1.4.

At the end a new point 1.5 should be inserted “*The creditor should ensure that the structure of remuneration, reward and performance management schemes for staff dealing with consumers in payment difficulties are aligned with the need to exercise reasonable forbearance*”

2. Engagement with the consumer

2.1 When a consumer goes into payment difficulties, the creditor should work with the consumer to establish why the difficulties have arisen and for the creditor to take appropriate steps.

2.2 The creditor should conduct meetings with the consumer in relation to their payment difficulties in privacy having regard to data protection legislation and not disclosing personal information to a third party without a consumer’s consent.

2.3 The creditor, as well as any agents acting on behalf of the creditor, should maintain a level of contact and communication with a consumer in payment difficulties that is proportionate to the information requirements, and not excessive.

The BSG supports the above requirements, but have other points to add.

Household customers who warn credit institutions about their risk of default due, for example, to being unemployed or ill, have a right to receive from the creditor a document informing them about their rights and duties. The creditor should also formally recognize in writing that it has received such a warning from the consumer.

Household customers in pre-arrears or arrears on the payment of their credit installments should receive information, advice and assistance from the entities in charge of debt advice. Recourse by the household customer to such entity should be free of charge.

In that sense, the procedure adopted in France to solve problems of debtors could be an example to follow. In certain cases, the debtor in good faith can go to a Committee formed by members of the administration, banking and consumer associations, which attempts to mediate between debtor and entity, proposing a

payment plan that may include “reduction of debts or debt moratorium”, and it can even ask the court to suspend a foreclosure that has been started. The Commission also assesses the degree of recklessness or negligence of the banks to grant credit and penalize them. Finally, the judge shall endorse and approve the proposed plan.

In the meetings conducted by creditors, which need to be organized in a private room/space, consumers should also have the right to be assisted by relatives, lawyers, representatives of consumer organisations, etc.

Creditors should engage sensitively with borrowers who have specific needs or circumstances which are likely to limit their ability to engage effectively: for example, customers dealing with bereavement or terminal illness, or those with physical and mental health issues.

These circumstances are not always consistently identified or appropriately probed by front-office staff, even when they are explicitly referred to by borrowers.

It is very important to be sure that fundamental rights as human dignity, privacy, safety, health etc. are respected by creditors and any other agents acting on behalf of creditors. Debt enforcement should respect the privacy of the debtors and not share any information with friends/ neighbors/relatives/colleagues. Any violent language or harassment that may lead to physical or psychological harm must be prevented. For some debtors, debt enforcement can cause illness or exacerbate some existing health problems. There needs to be assurances that debtors, especially the vulnerable ones, are treated sensitively and appropriately⁵.

There are many examples in practice of consumers being harassed by representatives of creditors, especially by employees working for debt collectors⁶. It would be very important to include into the Guidelines, at the end of point 2.3, a clear statement to discourage such practices.

3. Provision of information and assistance to the consumer

3.1 The creditor should have a consumer engagement policy in place. This should ensure that they provide adequate information, for example, through

⁵ For more examples, measures and recommendations please read chapter 5 - Restrictions on abusive debt collections practices from “Study on means to protect consumers in financial difficulty: personal bankruptcy, datio in solutum of mortgages and restrictions on debt collectors abusive practices”, December 2012, prepared by London Economics for the FSUG - http://ec.europa.eu/internal_market/finservices-retail/docs/FSUG/papers/debt_solutions_report_en.pdf

⁶ Please see an example case study here: http://ec.europa.eu/internal_market/finservices-retail/docs/FSUG/papers/debt_solutions_report_en.pdf, page 179

websites and written materials, and support for consumers in, or concerned about, payment difficulties.

3.2 The creditor should communicate clearly and in plain language.

3.3 The creditor should provide support and, at least, the following information to consumers in payment difficulties:

- a) the number of payments either missed or only paid in part;**
- b) the total sum of the payment shortfall;**
- c) the charges incurred as a result of the payment shortfall;**
- d) the importance of the consumer co-operating with the creditor to resolve the situation.**

3.4 In cases where the consumer's payment difficulties persist, the creditor should provide the following information to the consumer:

- a) information regarding the consequences of missing payments (e.g. costs, default interest rate, possible loss of property, etc.); and**
- b) information about available government/public schemes or support.**

The BSG supports the above requirements, but they should go a little further.

One of the most important challenges for consumers is to understand the very technical language used by bankers, both in contracts and in meetings. Creditors should take measures to be sure that the information provided is clear and well understood by all categories of consumers.

Consumer organisations in some countries have reported cases where the creditor was unable to switch direct debit payment dates to suit borrowers' circumstances, for example to facilitate prioritising of secured versus unsecured payments or to reflect the timing of salary payments; errors in manual 'workarounds' resulting in incorrect information being recorded on case files; unnecessary delays to case management; poor quality record-keeping and limited system performance, restricting staffs' access to full case details, and requiring borrowers to constantly re-explain sensitive circumstances or provide information on multiple occasions.

As regards fees and charges, charging practices should be fair and only reflect the additional resources required to administer the cases. Unless this is the case then creditors will be able to make additional profit when consumers are in

payment difficulties. A specific additional guideline should be introduced which should read: *“Creditors should only levy a charge where they are able objectively to justify that the charge is equal to or lower than a reasonable calculation of the cost of the additional administration required as a result of the customer being in payment difficulty”*.

4. Resolution process

4.1 The creditor should take into account the individual circumstances of the consumer, the consumer’s interests and rights and his/her ability to repay when deciding on which steps/forbearance measures to take. Forbearance measures consist of concessions towards a consumer facing, or about to face, difficulties in meeting his/her financial commitments.

Concessions to the consumer include:

- 1. a total or partial refinancing of a credit agreement; and/or**
- 2. a modification of the previous terms and conditions of a credit agreement, which may include amongst others:**
 - a) extend the term of the mortgage;**
 - b) change the type of the mortgage;**
 - c) defer payment of all or part of the instalment repayment for a period;**
 - d) change the interest rate;**
 - e) offer a payment holiday.**

The BSG supports the above requirements, but have some additional points to add.

Borrowers in arrears who are unable to pay on obligations under their credit agreements should have a right to enter into a settlement procedure that should apply to all types of mortgage credits, which should not depend on compliance with any conditions for access, nor specifically requested by the borrower.

Borrowers have a right to receive a document informing them about their rights and duties under the settlement procedure. Following the assessment of the borrower’s creditworthiness, the creditor should present one or more restructuring proposals deemed adequate to the borrower’s financial situation.

The borrower should be granted a series of guarantees. Among these, creditors should be prohibited from terminating credit agreements, bringing legal

proceedings against household customers with a view to redeeming credits, or assigning the said credits to third parties.

Borrowers with difficulties in paying housing credit instalments may request that credit institutions renegotiate the loan's financial conditions with a view to reducing the debt burden.

In case of renegotiation, credit institutions cannot increase the charges on credit agreements for the purchase or construction of owner-occupied homes, if such renegotiation has resulted in particular from a change in the credit holder due to divorce, legal separation, dissolution of a life partnership or death of either one of the spouses.

Household customers in arrears on credit agreements for owner-occupied homes who are in a particularly difficult economic situation should, on request, benefit from an extraordinary regime which could include the adoption of exceptional measures, which may lead to a partial or full cancellation of the debt. Such borrowers should benefit from a series of guarantees, notably the prohibition of credit institutions from foreclosing the mortgage.

Especially in those cases where the creditors acted not in line with the principles of "responsible lending", all consumers should have the right to be exempted, partly or even in full, from their debt. Special attitude should be adopted by creditors in those cases where a consumer becomes unemployed, is affected by a serious illness, faces a reduction of the hours worked, etc.

Thus, the BSG proposes to extend the list of the possible solutions, with the inclusion of two new points: 3) debt relief – writing-off of a portion of any outstanding debt, and 4) debt cancellation – writing-off of all remaining outstanding debt.

As it is clearly mentioned in the MCD that "Member States shall not prevent the parties to a credit agreement from expressly agreeing that return or transfer to the creditor of the security or proceeds from the sale of the security is sufficient to repay the credit", the BSG considers it important to include a new point (5): *datio in solutum* – borrowers who cannot repay their mortgage are released in full from the outstanding debt by handing their mortgage property over to the lender in cases that have been agreed between creditor and borrower. The "*datio in solutum*" should be the last-resort solution for the debtor, because the main objective is, as far as possible, to keep the home.

One of the arguments in favor of inclusion of this point is represented by the main conclusion on this issue of a study prepared for the Financial Services User Group (FSUG)⁷ by London Economics in December 2012, which stated that where

⁷ http://ec.europa.eu/internal_market/finservices-retail/fsug/index_en.htm

the consumer is informed that the lender wishes to move to enforcement, being able to evidence its efforts to agree and deliver a viable restructuring and the borrower's failure to comply with this, all consumers, irrespective of income, should be able to apply for *datio in solutum* immediately⁸.

5. Documentation of dealings with the consumer and retention of records

5.1 The creditor should document the reasons why the option(s) offered to the consumer are appropriate for his/her individual circumstances and should make and retain adequate records of its dealings with the consumer in payment difficulties for a reasonable period of time.

The BSG support the above requirements.

We consider that the records should be retained for at least 3 years.

2. Are there any additional requirements that you would suggest adding to the Guidelines? If so, outline the reason (s) for each proposed additional requirement.

Please see our response at Q1.

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Submitted on behalf of the EBA Banking Stakeholder Group

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⁸ "Study on means to protect consumers in financial difficulty: personal bankruptcy, *datio in solutum* of mortgages and restrictions on debt collectors abusive practices" – Best practice *Datio in Solutum* Model, page xv.