

Consultation Paper

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 draft Directive on credit agreements relating to residential immovable property



Contents

1.	Responding to this consultation	1
2.	Executive summary	2
3.	Background	3
4.	Options considered	5
5.	Draft regulatory TS on the minimum monetary amount of the professional indemnity insurance or comparable guarantee for mortgage credit intermediaries under Article 29 (2) (a) of Directive xxxx/xx/EU	15
6.	Accompanying documents	18

1. Responding to this consultation

The European Banking Authority (EBA) invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in section 6.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/rationale proposed; and
- describe any alternative regulatory choices you wish the EBA to consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by **18.03.2014**. Please note that comments submitted after this deadline or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form whether you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found in the [Legal notice section](#) of the EBA website.

2. Executive summary

Article 29 of the draft Directive on credit agreements relating to residential immovable property (Mortgage Credit Directive, MCD) requires Member States to ensure that mortgage credit intermediaries hold professional indemnity insurance (PII) against liability arising from professional negligence or a comparable guarantee, covering the territories in which they offer services. PII is a liability insurance aimed at covering, either entirely or in part, sums to be paid by professionals to third parties as compensation for losses arising from acts committed by the professional during the conduct of business activities.

In Article 29(2)(a) MCD, 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, to submit them to the Commission, and to review them every two years thereafter. In order to fulfil its mandate, the EBA carried out desk research, surveyed competent authorities in the 28 EU Member States to identify current national regulatory approaches to PII, and approached more than 40 insurance industry practitioners in 14 Member States to elicit their views. Following the assessment of these inputs, four options emerged by which the minimum amount could be determined:

- 1) Modelling the impact of various alternative minimum amounts on consumers and intermediaries and identifying a level that represents an appropriate trade-off between the conflicting aims of enhancing consumer protection and reducing the impact on intermediaries.
- 2) Pegging the minimum amount of the MCD PII to that set for insurance intermediaries in Directive No 2002/92/EC on insurance mediation (the Insurance Mediation Directive, IMD), which would result in a minimum amount of EUR 1 250 618 per claim and EUR 1 875 927 per year.
- 3) Setting the minimum amount at the lowest amount used in those Member States that already require PII for mortgage credit intermediaries, which would result in a minimum amount of EUR 100 000 per claim and EUR 150 000 per year.
- 4) Setting the minimum amount at the average of the amounts used in those Member States that already require PII for mortgage credit intermediaries, which would result in a minimum amount of EUR 584 000 per claim and EUR 886 000 per year.

Having assessed these options against the criteria of feasibility, methodological robustness, degree of consumer protection, compliance costs for intermediaries, compliance costs for national competent authorities (NCAs) and degree of proportionality, the EBA concludes that option 1 is methodologically most robust but cannot, at this early stage without access to the required data, feasibly be carried out. Option 2 is not methodologically robust and it is disproportionate to the assumed lower risk of claims arising from the activities of mortgage credit intermediaries.

Option 3 is not methodologically robust either and provides too low a degree of consumer protection. Although slightly better, option 4 is still not robust, achieves a higher degree of consumer protection than option 3 and incurs lower costs than option 2. Given the lack of methodological robustness, none of these options emerges as an uncontested favourite. Nonetheless, in the absence of other, superior options, option 4 is the preferred option and constitutes the proposal for the purpose of this consultation, as it currently best meets the criteria the EBA has used for assessing the options.

3. Background

The draft Directive on credit agreements relating to immovable residential property (Mortgage Credit Directive, MCD) was adopted by the European Parliament in the first reading/single reading on 10 December 2013.¹ The MCD aims to address a series of issues the European Commission had identified, including the lack of requirements pertaining to the professionalism, registration and authorisation of mortgage credit intermediaries. The Commission identified several concerns, including that national supervisory authorities (NSAs) may have little scope for supervision and/or may be unable to impose sanctions. This was seen as potentially resulting in an uncompetitive environment in which professionals who are responsible for misconduct, excessive risk-taking or poor advice may not be held to account. Furthermore, mortgage credit intermediaries' clients were found not always to have the right to receive redress in the event of a dispute.

These concerns were seen to be compounded when cross-border business was taken into consideration. Although cross-border activity is limited at present, a survey conducted by Europe Economics for the Commission's impact assessment showed that its significance is expected to increase as a distribution channel over the next five years,² further underlining the need for greater harmonisation of requirements.

The MCD seeks to address these concerns by stipulating that mortgage credit intermediaries should be subject to numerous requirements, including an admission process by the competent authority of their home Member State and ongoing supervision. Intermediaries are to meet strict professional requirements in relation to their competence, which are to apply at least at the level of the institution³. One of the requirements is set out in Article 29 MCD, which requires Member States to ensure that mortgage credit intermediaries hold professional indemnity insurance (PII) covering the territories in which they offer services, or some other comparable guarantee against liability arising from professional negligence.

PII is liability insurance aimed at covering, either entirely or in part, sums to be paid by professionals to third parties as compensation for losses arising from acts committed by the professional during the conduct of its business activities. The eligibility of compensation claims for the purpose of PII cover tends to be limited to those made by customers of the professionals, while those made by business partners tend to be excluded (although this may differ in individual cases). In Article 29(2)(a) MCD, the EBA is mandated to develop draft regulatory technical standards (RTS) to stipulate the minimum monetary amount of the PII or comparable guarantee, to submit them to the Commission 6 months after the directive enters into force, and to review them every two years thereafter.

The mortgage credit intermediaries to whom the PII requirement shall apply are defined in Article 4(5) MCD as:

'a natural or legal person who is not acting as a creditor or notary and not merely introducing, either directly or indirectly, a consumer to a creditor or credit intermediary, and who, in the course of his trade, business or profession, for

¹ See: [http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2011/0062\(COD\)](http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2011/0062(COD))

² See footnote 57 in European Commission (2011), *Commission Staff Working Paper Impact Assessment – Accompanying document to the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property*, p. 16, at http://ec.europa.eu/internal_market/finances-retail/docs/credit/mortgage/sec_2011_356-ja_en.pdf.

³ See Recital 69 MCD.

remuneration, which may take a pecuniary form or any other agreed form of financial consideration:

- a) presents or offers credit agreements to consumers;*
- b) assists consumers by undertaking preparatory work or other pre-contractual administration in respect of credit agreements other than referred to in a point (a); or*
- c) concludes credit agreements with consumers on behalf of the creditor.'*

Article 29(2)(a) MCD provides that the PII requirements apply in principle to all mortgage credit intermediaries. However, for tied mortgage credit intermediaries, the home Member State may provide that such insurance or comparable guarantee can be provided by a creditor for which the mortgage credit intermediary is empowered to act.

4. Options considered

In order to fulfil the mandate envisaged in Article 29(2)(a) MCD, the EBA sought to collate evidence and identify the most suitable, robust and representative way in which the minimum monetary amount for the PII coverage level or comparable guarantee could be calculated. The EBA carried out desk research, surveyed competent authorities in the 28 EU Member States to identify current national regulatory approaches to PII and approached more than 40 insurance industry practitioners across 14 Member States to elicit further views. Having assessed these inputs, four options emerged on how the mandate could be implemented:

- 1) Modelling the impact of different minimum monetary amounts in terms of benefits to consumers and costs to intermediaries and identifying an amount that represents an appropriate trade-off between these conflicting considerations.
- 2) Pegging the minimum amount to that set for insurance intermediaries in the IMD.
- 3) Setting the minimum amount at the lowest amount used in those Member States that already require PII for mortgage credit intermediaries.
- 4) Setting the minimum amount at the average of the amounts used in those Member States that already require PII for mortgage credit intermediaries.

Each of these options is outlined below and assessed against the following criteria:

- a) *feasibility* of obtaining the relevant data, calculating the threshold and implementing it across the 28 Member States;
- b) *methodological robustness* of the approach used to calculate the minimum amount;
- c) *degree of consumer protection* that will be achieved by a given calculation approach and resultant minimum amount;
- d) *compliance costs for mortgage credit intermediaries* that will accrue as a result of the additional insurance they will have to take out, such as insurance premiums;
- e) *compliance costs for NCAs* that will accrue as a result of having to implement the minimum level in their jurisdictions; and
- f) *proportionality* of the approach: it should reflect different characteristics and indemnity risks, both between mortgage credit intermediaries and between mortgage credit intermediation activities and other, similar activities carried out by populations of professionals, such as insurance intermediation, with a view to ensuring that the burdens imposed on an addressee do not exceed what is necessary to achieve the objectives pursued.

The EBA is interested in hearing respondents' views on the options considered, on any option the EBA may not have considered and on the option identified as the preferred option outlined in section 4.5 below.

4.1 Option 1: modelling the benefits and costs of different minimum amounts

In an ideal scenario, the EBA would, for each of the 28 EU Member States, have access to comprehensive data on the following characteristics of the market and of the intermediary population:

- the number of mortgages sold through mortgage credit intermediaries;

- the number and amount of compensation claims lodged by borrowers against mortgage credit intermediaries;
- the number and amount of claims subsequently paid and of settlements reached;
- the number of claims paid by reason (e.g. misselling, maladministration, etc.);
- the insurance premiums paid by mortgage credit intermediaries (and/or, as a proxy, by other insured entities) at various coverage amounts;
- the profit levels of mortgage credit intermediaries; and
- the costs to consumers of buying a mortgage through intermediaries (in terms of fees, charges, interest rate differentials to direct sales, etc.).

The analysis of such data would allow the EBA to develop a set of alternative minimum amounts and model the impact for each of them on:

- claimants, as measured by the percentage share of claims that would be met at that amount;
- intermediaries, as measured by the reduction in profits arising from the additional premiums; and
- consumers, as measured by the increases in charges and fees to which they may be exposed as a result of intermediaries passing on the premium costs to them.

A natural trade-off exists between the conflicting aims of maximising the protection of consumers and minimising the impact on intermediaries: the higher the minimum amount per year (or per claim), the larger the percentage share of claims that could be met (or that could be met in full) but, other things being equal (such as turnover, type of business activity), the more costly the insurance premium, the greater the impact on intermediaries will be, and vice versa. These impacts could, then, be modelled across a number of different minimum levels, which would allow the EBA to make a better-informed judgement about the level that would produce the most appropriate balance between these conflicting aims and that would therefore be the preferred option to propose to the European Commission.

To turn to the criteria set out at the beginning of this paper, option 1 would result in a very robust methodological approach, which could then be fine-tuned to arrive at (a) minimum amount(s) that would achieve greater proportionality between different types of mortgage credit intermediaries. The degree of consumer protection achieved, as well as the premium costs accruing to intermediaries, would depend on the exact level at which the minimum amounts(s) would be set, and so cannot be assessed at this stage. However, other compliance costs for intermediaries, as well as compliance costs accruing to NCAs, would probably be high, as the gathering of these data would require reporting processes to be set up (by NCAs) and complied with (by insurance intermediaries and, possibly, insurance undertakings).

The criterion against which this option would be least successful is that of feasibility. The data sought above are not readily available across all 28 Member States, owing to national differences in the scope of regulation, the definitions and the market characteristics. With regard to the scope of regulation, many jurisdictions impose only moderate or limited statutory requirements on mortgage credit intermediaries. Although regulation of transparency towards consumers and lenders is relatively common, prudential standards (that might generate the profits data sought above) are uncommon, as

are requirements on complaints (as precursors to subsequent compensation claims) or other reporting requirements (to determine sales volumes, fees and charges)⁴.

The definition of mortgage credit intermediaries varies, too, in that different categories of intermediaries may apply, such as brokers, agents, financial consultants, mortgage credit intermediaries and consumer credit intermediaries. For example, mortgage credit intermediaries are specifically defined in only seven Member States (Austria, Belgium, Estonia, Ireland, Malta, the Netherlands, and the UK). 12 Member States have only general definitions of intermediation that may not be specific but apply to certain mortgage credit intermediaries, while the remaining seven Member States do not have a legal definition at all.

Finally, market characteristics differ between jurisdictions, particularly with regard to the significance of intermediated versus direct sales of mortgages: only five Member States have mortgage markets with an intermediary penetration of 25% or more (Ireland, the UK, the Netherlands, Germany and Austria)⁵, while the others feature much lower shares, often as low as 0% to 5%. Similarly, the number of staff employed by intermediaries is skewed heavily towards the same set of countries: the UK alone is home to more than half of the 47 000 to 64 000 individuals estimated to be employed across the EU⁶. In short, the scale of intermediation differs between countries and, unsurprisingly, so does the degree of regulatory attention to which intermediation has been exposed.

Even if the above data were available, estimating what would be an appropriate minimum level of PII would be a challenge: it would imply comparing a cost which is definite but very difficult to estimate for the initial years – i.e. the amount of premium given a minimum level of coverage – with a benefit that is probabilistic – i.e. the redress paid out to consumers, which is idiosyncratic and difficult to model with confidence.

As a result of these considerations, the EBA does not consider option 1 to be a feasible option at this early inception stage, but it would want to reassess this option during the reviews it will be mandated to carry out in the future.

4.2 Option 2: pegging the minimum amount to the Insurance Mediation Directive

The EBA considered the alternative option of pegging the minimum amount of the PII or comparable guarantee in the MCD to the minimum amount prescribed for insurance intermediaries in the IMD, which amounts to EUR 1 250 618 per claim and EUR 1 875 927 per year respectively⁷. As in the other options considered in this paper, PII for mortgage credit activities would be in addition to any other, already existing, cover the intermediary may have taken out (such as PII for insurance intermediation activities), and this would, coincidentally, result in a doubling of the coverage level compared with the IMD PII.

The *prima facie* advantage would be one of simplicity and practicality: intermediaries that carry out both insurance intermediation *and* mortgage credit intermediation would see their minimum amount double, national regulators would have to oversee the application of only one amount for each of the two activities, and the reviews to be conducted by the EBA in subsequent years could be simplified significantly.

⁴ European Commission (2009), *Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H)*, pp. 71-3, available at http://ec.europa.eu/internal_market/finservices-retail/credit/intermed/index_en.htm

⁵ *Ibid*, p. 96

⁶ *ibid*, p. 111

⁷ Article 4(3) of Directive 2002/92/EC on insurance mediation (IMD)

However, the disadvantage would be that such an approach does not take account of differences between the activities of mortgage intermediation and insurance intermediation in terms of the number of compensation claims and the compensatable loss of the types of claim to which the activities could give rise. The EBA is unable to obtain data to quantify and provide evidence for these differences, for the reasons outlined in option 1 above. However, the EBA's assumption is that the risk for mortgage credit intermediaries is lower. This conclusion results from the following observations.

First, although a mortgage tends to be the largest financial transaction many consumers enter into in their lives, the nature of the detriment as compensatable loss they could potentially experience is limited. For example, unlike insurance policy holders, mortgage borrowers do not pay a monthly premium that could be lost or misappropriated by the intermediary.

Second, with an insurance product, the consumer expects a sum of money long after the contract was initially signed, when an event occurs that would give rise to the payout (e.g. accident, flooding, unemployment, death). The consumer would suffer considerable detriment if that money were, against her expectations, not made available at that point in time, owing to the intermediary's misselling, maladministration, fraud or other triggers. By contrast, in a mortgage transaction, the consumer receives the money (i.e. the loan) upfront, when the contract is signed. The mortgage lender and intermediary fulfil their commitments instantaneously, and no expected transfer could potentially remain unfulfilled; this significantly reduces the extent of detriment and compensatable loss.

Third, any resultant detriment a mortgage borrower may experience is likely to be lower in terms of the monetary amount at stake. Unlike the case of the insured sum with an insurance intermediary, the mortgage loan itself is never at stake in the case of a mortgage credit intermediary.

Fourth, should a borrower decide to claim that he should never have received the loan because the amount turned out to be unaffordable, which in turn led to his property being repossessed, such a claim would not be directed at the intermediary. Rather, it would have to be directed at the lender as creditor, as the entity that underwrote the loan and the credit risk associated with it. It is also reasonable to assume that, were such a claim to be honoured by the creditor, any monetary loss suffered by the borrowers would first be offset against the financial benefit the borrower received from having been granted the loan in the first place. As a result, the eligible grounds for claims are unlikely to be linked to the loan amount or the value of the property as collateral. Rather, in all probability, it will be limited to excessive charges, fees and interest rates compared with the consumer's reasonable expectations, non-competitive products or unsuitable sales, reducing the number of claims and the amount of compensatable loss further still⁸.

Fifth, mortgage intermediaries are unlikely to face claims because of fraud and misappropriation because, unlike investment intermediaries, they do not receive client monies that they could fail to hold in separate client accounts and, unlike the practice of insurance intermediaries in some jurisdictions, they do not handle payments made by an insurer to an insured party under a successful claim.

Sixth, in some Member States, borrowers switch their mortgages frequently, often every 2, 3 or 5 years, without incurring early repayment charges. To the extent that this is the case, borrowers are more likely to be able to avoid sustained detriment throughout the term length of the mortgage, by refinancing and switching to a better deal.

⁸ Ibid., pp. 122–4.

The EBA therefore surmises that the number and size of claims likely to be levied at mortgage credit intermediaries will be lower. However, the EBA recognises that this view may not be shared by everyone. The industry practitioners that were approached by the EBA, for example, had a split view: of the 15 individuals who provided a response to the question about whether they considered the risk of mortgage intermediation to be lower, the same or higher, five respondents considered it to be lower, five thought it to be the same and the other five considered it to be higher. The arguments put forward amongst those who thought mortgage credit intermediaries posed a higher risk included that the loss may be easier to prove, that national real estate markets were inherently unstable and that mortgage credit intermediaries may conduct significant amounts of cross-border business. Given the diversity of these responses, the EBA is interested in hearing respondents' views on this option.

When assessed against the criteria set out at the beginning of this paper, option 2 scores well with regard to feasibility, as no additional reporting data or modelling would be required. The degree of consumer protection achieved would be very high. Compliance costs for NCAs would be minimal, as no additional reporting requirements would need to be set up. Compliance costs for intermediaries would be low in terms of administrative burdens, owing to the absence of additional reporting compliance. Yet their compliance costs would be high in terms of additional premium costs because, if the assumptions set out above are correct, mortgage credit intermediaries would be required to take out coverage levels that do not reflect the lower risk of claims to which they are exposed, with concomitant (but not necessarily proportional) increases in the insurance premiums. For the same reason, the proportionality criterion would not be met, as it appears that the burden imposed on intermediaries compared with other populations of similar professionals would be disproportionate.

Most importantly, the robustness criterion would not be met. The minimum PII amount for mortgage credit intermediaries would be pegged to the minimum level for another industry, which itself was calculated based on a methodology that is not necessarily robust. Furthermore, the methodology of the minimum PII amount is itself under periodic review and may therefore change over time, in ways that may not be appropriate for mortgage credit intermediation.

As a result of these considerations, the EBA does not consider option 2 to be a desirable option.

4.3 Option 3: setting the minimum amount at the lowest amount used in Member States

The EBA assessed, as a third option, the approaches used in national jurisdictions. To that end, the EBA conducted a mapping exercise with 28 NSAs, in order to obtain specific information about the extent to which PII requirements already exist for intermediaries, to establish the extent to which different triggers for claims are covered by PII policies and to ascertain the minimum amounts that already exist. By way of summary, the survey revealed that, from the 22 responses received, PII for mortgage credit intermediaries is mandatory in only seven Member States: Austria, France, Italy, the Netherlands, Slovakia, Spain and the United Kingdom. What is more, as depicted in Table 1 in the impact assessment section, the details of the regulatory requirements differ widely between these jurisdictions:

- *The application of the PII cover differs*, in that 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 amounts per year vary between EUR 150 000 and EUR 1 750 000.

- The minimum amount is *multi-tiered* in four jurisdictions, where it is tied 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 *IMD*, whereas in the others it is not.
- *Comparable guarantees* are provided in only six of the seven Member States. In one Member State, the guarantee is an additional requirement if a mortgage credit intermediary receives funds from the public. Two others accept it as an alternative. In yet another jurisdiction, a guarantee is presently required, but there are not any intermediaries that would fulfil the legislative requirement for needing to take it out.
- *Historical claims data*, i.e. statistics on the frequency of claims, could be provided by only one of the seven Member States, which is insufficiently representative of the 28 EU Member States, despite the country in question featuring a particularly sizeable market.
- The *triggers* for insurance cover appeared to be the most homogeneous aspect of the survey responses, in that misselling, malpractice/maladministration, unsuitable advice and negligence appeared to be permissible events that could trigger the claims, whereas fraud and unauthorised business tend to be excluded in PII policies.

Given the diversity of approaches used across the seven jurisdictions, no unequivocal good practice emerges that would indicate which particular approach the EBA should adopt. However, one approach would be to set the minimum amount to the lowest amount used amongst those Member States that already have regulatory requirements. This would amount to EUR 100 000 per claim and EUR 150 000 per year.

Given that the MCD is looking for a *minimum* level at which the RTS should be set, this approach would not be entirely implausible: the RTS would be set at the lowest level that currently applies within the EU and, thus, would not impose a burden beyond that considered proportionate by an NCA that already has PII requirements in place. NCAs with more exacting levels could, of course, retain those they already have. In addition, as time progresses and the EBA carries out periodic reviews of the minimum amount, the RTS can be adjusted, upwards if necessary, to reflect the claims data that will emerge over time.

Assessed against the criteria set out at the beginning of the paper, option 3 would achieve a relatively high degree of feasibility and an adequate but still low degree of methodological robustness. It is adequate because nothing better is available at this early inception stage but it is also low, owing to the limited degree of representativeness of the country on which this amount is based: in terms of characteristics such as market size or market development, Slovakia is not necessarily representative of the rest of the EU. For example, with 15 000 intermediated mortgages, Slovakia has a share of only 0.4% of all intermediated mortgages in the EU amongst the 28 Member States⁹.

The degree of consumer protection achieved is lower than that achieved in options 2, 4 and probably also 1 (subject to the assessment to be carried out as and when the required data are available). For the reasons stated in option 1 above, it is not possible to quantify the percentage share of claims and aggregate amounts were the minimum amounts of EUR 100 000 per claim and EUR 150 000 per year to apply, but it is reasonable to assume that option 3 will result in the lowest figure of the four options assessed.

⁹ Ibid., p. 95.

Compliance costs for intermediaries would be low, as premium costs would be low and no additional reporting requirements would arise. Compliance costs for NCAs would be low, too, at least for the Member States with existing PII requirements, which would not be required to change them. Costs would accrue to the other Member States, but these costs would be the same as those accruing in options 2 and 4. The option would also be more proportionate than option 2 with regard to the comparative risk of exposure of mortgage credit compared with insurance intermediaries. Arguably, however, the resultant level is disproportionately too low, although it is not possible to support this statement with data.

Finally, the lower the level at which the minimum cover is set, the more likely Member States will be to set their national requirements at that minimum level, and the less likely it is that a level playing field will be achieved between such Member States and those that have set higher minimum levels.

As a result of the above considerations, and the low degree of consumer protection achieved in particular, the EBA does not consider option 3 to be a desirable option.

4.4 Option 4: setting the minimum amount at the average of the amounts used in Member States

A fourth and final option that the EBA considered was to take guidance from the Member States in a way that is similar to but also different from option 3 and to extrapolate from their requirements using some simple and untested assumptions. The existing national requirements summarised under option 3 can be drawn upon to determine two important elements of the regime: (i) whether the minimum amounts should be applied only per year or also per claim, and (ii) the level(s) at which the amounts should be set.

With regard to the question of whether a minimum amount should be applied only per year or also per claim, the EBA proposes the latter. Mortgage intermediaries, and their PII insurers, are familiar with a per-year-and-per-claim approach, given that many also carry out insurance intermediation activities and are therefore subject to the two-pronged approach imposed by the IMD. Further, the majority of the seven Member States with mortgage PII requirements employ such an approach.

With regard to the setting of the minimum amounts, the EBA proposes to calculate a simple average from the responses provided. The data provided by Austria, France, the Netherlands, Slovakia and the UK for the minimum per claim (EUR 1.1 million, EUR 0.5 million, EUR 1.12 million, EUR 0.1 million and EUR 0.1 million respectively, as set out in detail in the impact assessment annex) result in an average amount of EUR 584 000 per claim. Similarly, for the coverage level per year, the data provided by Italy, France, the Netherlands, Slovakia, the UK and Spain result in an average of EUR 886 000 per year. In order to arrive at this figure, and given that the MCD will mandate the EBA to define the *minimum* amount, the lower bounds of the data provided by these countries (EUR 1 million, EUR 1.7 million, EUR 0.8 million, EUR 1.68 million, EUR 0.15 million, EUR 0.5 million/EUR 0.57 million and EUR 0.3 million respectively) were used.

Evaluated against the assessment criteria, option 4 would achieve a high degree of feasibility (akin to that of option 3), and a degree of methodological robustness that is slightly higher than that of option 3, because the sample of countries includes the jurisdictions (such as the Netherlands, Austria and the UK) that have the highest shares of intermediated mortgage sales across the 28 Member States in the

EU¹⁰, a history of significant market penetration by mortgage intermediaries and, therefore, more developed approaches to regulating this sector. It is therefore methodologically not unreasonable to look towards these countries, even if they are few in number, for guidance on the most suitable regulatory approach to be taken.

Developed mortgage markets tend to be characterised by developed housing markets and, as a result, high house prices and high mortgage credit amounts. Because of this, it might be thought disproportionate or unfair to use these markets to calculate coverage levels that are then imposed on countries with much less developed mortgage and housing markets. However, the EBA believes that this is not a convincing argument because, unlike in the cases of insurance and investment intermediaries, a claim made against a mortgage intermediary that would trigger a PII payout is not correlated to the amount of credit that is taken out. As explained in section 4.2, a claim lodged by a consumer would be based primarily on maladministration, misselling, or excessive charges or interest rates, which are triggers that are not, or only very indirectly, related to the mortgage credit amount.

The degree of consumer protection achieved is higher than in option 3 but lower than in option 2 (EUR 1.2 million and EUR 1.68 million respectively), thus chiming with the hypothesis set out in option 2 that mortgage credit intermediaries pose a relatively low risk. It is the second highest of all four options considered (subject to the assessment to be carried out for option 1). Compliance costs for intermediaries would be lower than in option 2 but higher than in option 3. Compliance costs for NCAs would be higher, at least for the Member States with existing PII requirements that are set lower than, or differently from, those of option 4. However, as in options 2 and 3, the level would not be proportionate to the different degrees of risk between different mortgage credit intermediaries.

4.5 Conclusion regarding the options considered

From the four options presented, the EBA considers option 4 to be the preferred one to pursue, as it is feasible and scores reasonably well on the other criteria, too. Option 4 therefore constitutes the basis on which the EBA has drafted the RTS proposed to the Commission that are set out in section 5 below.

Being calculated as an average, the minimum amounts in option 4 are specified with some precision. When reviewing the consultation feedback, the EBA will also consider the case for 'rounding' the minimum amounts contained in the RTS.

The mandate given to the EBA is ongoing, in that it will be required to review the minimum amount of PII every two years. Given this, the EBA expects that option 1 may become a more feasible option as time progresses and as some of the required historical data become available. Future reviews will therefore seek to move closer to option 1.

Q1: Do you agree that, of the four options presented, option 4 (i.e. setting the minimum amount at the average of the amounts used in Member States) is the option the EBA should pursue, resulting in a minimum amount of EUR 584 000 per claim, and EUR 886 000 per year?

¹⁰ Ibid., pp. 96, 122.

Q2: Do you consider the number and the compensatable loss of compensation claims arising from the activity of mortgage intermediation to be lower than, the same as, or higher than those arising from insurance intermediation? Please explain your reasoning.

Q3: Do you know of options other than those listed in this consultation paper that the EBA should consider when deciding on the minimum amount of coverage?

4.6 Potential enhancements to achieve greater proportionality

Irrespective of which of the options is eventually chosen, the separate question arises of the desirability of achieving greater proportionality between different intermediaries. All the above options would lead to all intermediaries being treated in the same way, as they would be subject to the same PII coverage level irrespective of different degrees of exposure to compensation claims.

This outcome could be enhanced by requiring different minimum amounts for different sets of intermediaries, with a view to ensuring that the burden imposed on an addressee does not exceed what is necessary to achieve the objectives pursued. This would mean setting one or more thresholds. The PII premium for an intermediary below the relevant threshold would then benefit from a lower minimum amount than an intermediary above the threshold. The EBA is seeking views from respondents on whether or not such a variant would be desirable, which indicator should be used to bring about the proportionality, how the threshold(s) for the chosen indicator should be calculated and how many thresholds, or tiers, should be introduced. The following issues may suitably be considered.

First, the *desirability* of greater proportionality has to be weighed against additional administrative costs that may accrue to intermediaries, NCAs or other parties to achieve said proportionality. For example, additional data might be required from intermediaries and/or insurance undertakings in order to be able to calculate the threshold(s) for the chosen indicator and assess periodically whether individual intermediaries fall below or above the chosen threshold(s).

Second, the *choice of indicator* should be informed by its reliability in reflecting the risk of compensation claims, in terms of claim amount and frequency. The industry practitioners surveyed suggested that potentially suitable indicators include intermediaries' turnover, number of agents employed, number of branches, number of customers and type, and thus riskiness, of mortgage business carried out.

Third, the *calculation of the threshold* should arguably be robust and reasonably stable over time, in order not to incur excessive administrative costs arising from frequent reclassifications.

Fourth, the *number of thresholds* would need to be determined. One option would be to use a simple two-tier system, but additional thresholds are conceivable, and so is a sliding scale threshold, for example by calculating a percentage of a given indicator.

Finally, *threshold effects* might occur, in that a significant burden would be added or fall away for those intermediaries close to the threshold and whose tier classification changed frequently over time.

Q4: Do you consider threshold(s) that distinguish between more than one minimum amount of PII coverage to be a desirable feature? If so, please explain how such a threshold should be devised.

5. Draft regulatory TS on the minimum monetary amount of the professional indemnity insurance or comparable guarantee for mortgage credit intermediaries under Article 29 (2) (a) of Directive xxxx/xx/EU

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

**supplementing Directive XXXX/xx/EU of the European Parliament and of the Council
on credit agreements relating to residential immovable property with regard to
regulatory technical standards on professional indemnity insurance or comparable
guarantee for credit intermediaries**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to Directive xxxx/xx/EU of the European Parliament and of the Council of
dd/mm/yyyy on credit agreements relating to residential immovable property....¹¹, and in
particular Article 29(2)(a) thereof,

Whereas:

- (1) Article 29(2)(a) of Directive XXX requires credit intermediaries to hold a professional indemnity insurance covering the territories in which they offer services or some other comparable guarantee against liability arising from professional negligence.
- (2) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (3) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

Article 1

The minimum monetary amount of the professional indemnity insurance or comparable guarantee referred to in the first paragraph of Article 29(2)(a) of Directive xxxx/xx/EU and required to be held by credit intermediaries shall be at least EUR 584 000 applying to each claim and in aggregate EUR 886 000 per year for all claims

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

¹¹ OJ.....

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

6. Accompanying documents

6.1 Draft Cost- Benefit Analysis / Impact Assessment

Article 15 (1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft regulatory technical standards developed by the EBA are submitted to the Commission for adoption, they should be accompanied by an analysis of ‘the potential related costs and benefits’. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

6.1.1 Problem definition and objective of the RTS

The European Commission has identified issues relating to non-existing professional requirements for mortgage credit intermediaries, including misconduct, excessive risk-taking or poor advice by mortgage credit intermediaries. In response, and in the light of its expectation of increased cross-border intermediation, the EU Commission included in the MCD provisions aimed at improving the competence and reputation of mortgage credit intermediaries. These include the requirement for intermediaries to take out PII or a comparable guarantee. The EBA has been mandated to develop draft RTS to set the minimum monetary amount of the PII or some other comparable guarantee.

6.1.2 Baseline current regulatory framework and market practices

In order to inform the impact assessment for these proposed RTS, the EBA gathered information from NSAs on existing PII requirements across the EU Member States. The EBA received detailed responses from 22 of the 28 NSA approached. Of these, seven reported that PII is an existing mandatory requirement for mortgage credit intermediaries, whereas 15 others had no such requirements. As can be seen in Table 1 below, the requirements in the seven countries differ significantly in terms of their coverage levels and any thresholds to determine variations in those coverage levels.

Table 1: PII coverage levels for mortgage credit intermediaries in seven EU Member States

Country	Per Claim	Per Year	Other type of requirements & comments
Italy	<ul style="list-style-type: none"> – if annual turnover (Y) in the year before the contract is <= EUR 100 k, then the minimum amount per claim (MAC) is EUR 0.5 m – if Y is > EUR 100 k < EUR 500 k, then MAC is EUR 0.75 m – if Y is => EUR 500 k, then MAC is EUR 1.25 m 	<ul style="list-style-type: none"> – if annual turnover (Y) in the year before the contract is <= EUR 100 k, then the minimum amount per year (MAY) is EUR 1 m – if Y is > EUR 100 k < EUR 500 k, then MAY is €1.25m – if Y is => EUR 500 k, then MAY is EUR 1.75 m 	
Austria	EUR 1 111 675	EUR 1 677 513	<ul style="list-style-type: none"> – Minimum levels defined in Austrian Trade Regulation Act (Article 136a, paragraph 12); do not apply to comparable guarantees – The minimum levels were adopted on 15 January 2013, and will be reviewed/aligned with price index every 5 years
France	EUR 500 000	EUR 800 000	
Slovakia	Not less than EUR 100 000	Not less than EUR 150 000	<ul style="list-style-type: none"> – Where co-insurance is agreed, it may amount to not more than 1% of the agreed claim payment
UK			<ul style="list-style-type: none"> – The higher of 10% of annual income up to GBP 1 million and GBP 100 000 for a single claim or GBP 500 000 in the aggregate – Firms should also hold a prescribed amount of additional capital resources if policy excess exceeds: <ul style="list-style-type: none"> – GBP 2 500 and 1.5% of annual income if firm does not hold client assets; – GBP 5 000 and 3% of annual income where it does – A firm does not require PII if it has net tangible assets of more than GBP 1 million or it has a comparable guarantee
Spain			<ul style="list-style-type: none"> – For the first year, EUR 300 000 multiplied by the number of business premises of the intermediary – For any other year, the higher of the following two values: <ul style="list-style-type: none"> – the preceding year's minimum coverage multiplied by the annual inflation rate (Consumer Price Index); – 30% of the preceding year's turnover stemming from the two activities that fall within the scope of the aforementioned regulations
Netherlands	EUR 1 120 200	EUR 1 680 300	<ul style="list-style-type: none"> – Mortgage credit intermediaries tend to have PII as a result of their carrying out the activity of insurance intermediation, which is subject to the coverage level provided in the IMD

A similar picture emerges with regard to PII coverage level. National practices vary also in terms of comparable guarantees: they exist in only six EU Member States and the factors affecting the levels and the structure of the guarantee differ significantly, as set out in Table 2 below. The intermediaries

subject to the requirements in the seven Member States where PII is already mandatory for mortgage credit intermediaries account for approximately 70% of the total intermediary population in the EU¹².

Table 2: Comparable PII guarantees for mortgage credit intermediaries in six Member States

Country	Comments
France	If a credit intermediary receives funds from the public, it has to subscribe, in addition to PII, to a financial guarantee that at least covers EUR 115 000, or at least twice the average of the funds collected
Italy	Currently only a few Italian insurance brokers distribute PII contracts. They are produced by UK-based insurance companies
Spain	As a prerequisite for initiating their business, credit intermediaries shall hold PII or an equivalent bank guarantee, without further specification, against liability arising from their professional activity
Belgium	There are (i) guarantees; (ii) the obligation of the intermediary to deposit the premium paid by the customer to the (credit) financial institution which liberates the customer from its obligations (customer pays only once); and (iii) the obligation of the (credit) financial institution to reimburse the customer in case the intermediary has not put the money on the client's account (the financial institution risks paying twice)
UK	A credit intermediary is allowed to use a comparable guarantee as an alternative to PII. Such a guarantee should be from another authorised person which has net tangible assets of more than GBP 1 million, and if the firm is a member of a group with an authorised person with such net tangible assets, the comparable guarantee must be from that person. A comparable guarantee means a written agreement on terms at least equal to those in a contract of professional indemnity insurance to finance the claims that might arise as a result of a breach by the firm of its duties under the regulatory system or civil law
Norway (non-Member State)	The regulation for independent credit intermediaries (FOR 1990-09-14 #764) requires all intermediaries to have a minimum guarantee for their activities of NOK 25 million. The coverage can be given as a credit guarantee, as an insurance guarantee or as a deposit in a credit institution or deposit of securities

6.1.3 Assessment of the impact of the options considered

Approximately 70% of the mortgage credit intermediaries in the EU are already subject to PII requirements or comparable guarantees. The majority of the remaining 30% are likely also to carry out insurance intermediation activities, and are, therefore, subject to the minimum amounts provided in the IMD. For the vast majority of the addressees of these RTS, PII coverage or comparable guarantees are therefore not a new requirement that would require major organisational changes for intermediaries or NSAs.

Several of the seven Member States may need to make upward adjustments in order to reach the minimum amounts prescribed in this RTS, and 21 Member States, with a very low penetration of mortgage intermediaries, will have to introduce a new requirement. To the extent that mortgage intermediaries also carry out insurance intermediation activities, the additional requirement will result in firms needing to take out additional coverage through a PII or comparable guarantee to cover the additional activity of mortgage intermediation.

The premiums that insurance undertakings will be charging, and the resultant costs that will accrue, are difficult to anticipate, given the lack of data available for mortgage intermediaries on historic claims, premium levels and the correlation between them. This is likely to result in relatively high

¹² Ibid, p. 110.

premiums charged by insurance undertakings in the initial years, until they can avail themselves of such data.

The effect is compounded further by the current lack of competition amongst insurance undertakings. The responses from the 40 industry practitioners the EBA approached suggested that competition will increase (all respondents indicated that the number of firms would increase, and at times significantly so, once the PII coverage or comparable guarantee became a requirement). However, it is reasonable to assume that it will take a year or two until such increased competition has any effect on premiums, and that they will be high initially.

Irrespective of the estimated development of insurance premiums and costs accruing over time, the detailed impact in terms of additional costs accruing to intermediaries will vary significantly depending on the level at which the minimum amounts are to be set. In order to fulfil its mandate, the EBA sought to collate evidence and identify the most suitable, robust and representative way in which the minimum monetary amount could be calculated. The EBA carried out desk research, surveyed competent authorities in the 28 EU Member States to identify current national regulatory approaches to PII and approached more than 40 insurance industry practitioners in 14 Member States to elicit further views. Having assessed these inputs, four options emerged for how best to implement the mandate, each of which would result in different levels of compliance costs for intermediaries:

- 1) Modelling the impact of different minimum monetary amount in terms of benefits to consumers and costs to intermediaries and identifying an amount that represents an appropriate trade-off between these conflicting considerations.
- 2) Pegging the minimum amount to that set for insurance intermediaries in the IMD, which would result in a minimum amount of EUR 1 250 618 per claim and EUR 1 875 927 per year.
- 3) Setting the minimum amount at the lowest amount used in those Member States that already require PII for mortgage credit intermediaries, which would result in a minimum amount of EUR 100 000 per claim and EUR 150 000 per year.
- 4) Setting the minimum amount at the average of the amounts used in those Member States that already require PII for mortgage credit intermediaries, which would result in a minimum amount of EUR 584 000 per claim and EUR 886 000 per year.

Each of these options is outlined below and assessed against the following criteria:

- *feasibility* of obtaining the relevant data, calculating the threshold and implementing it across the 28 Member States;
- *methodological robustness* of the approach used to calculate the minimum amount;
- *degree of consumer protection* that will be achieved by a given calculation approach and resultant minimum amount;
- *compliance costs for mortgage credit intermediaries* that will accrue as a result of the additional insurance they will have to take out, such as insurance premiums;
- *compliance costs for NCAs*) that will accrue as a result of having to implement the minimum level in their jurisdictions; and
- *proportionality* of the approach: it should reflect different characteristics and indemnity risks, both between mortgage credit intermediaries, and between mortgage credit intermediation

activities and other, similar activities carried out by populations of professionals, such as insurance intermediation, with a view to ensuring that the burdens imposed on an addressee do not exceed what is necessary to achieve the objectives pursued.

When assessed against these criteria, none of the four options emerges as an uncontested favourite. Option 1 would result in a very robust methodological approach, which could then be fine-tuned to arrive at minimum amount(s) that would achieve a greater proportionality between different types of mortgage credit intermediaries. The degree of consumer protection achieved, as well as the premium costs accruing to intermediaries, would depend on the exact level at which the minimum amounts(s) would be set, and so cannot be assessed at this stage.

However, other compliance costs for intermediaries, as well as compliance costs accruing to NCAs, would probably be high, as the gathering of these data will require reporting processes to be set up (by NCAs) and complied with (by insurance intermediaries and, possibly, insurance undertakings). The criterion against which this option would be least successful is that of feasibility. The data sought above are not readily available across all 28 Member States. As a result, the EBA does not consider option 1 to be feasible.

Option 2, in turn, would score well with regard to feasibility, as no additional reporting data or modelling would be required. The degree of consumer protection achieved would be very high. Compliance costs for NCAs would be minimal, as no additional reporting requirements would need to be set up. Compliance costs for intermediaries would be low in terms of administrative burdens, owing to the absence of additional reporting compliance. Yet their compliance costs would be high in terms of additional premium costs because, if the assumptions set out above are correct, mortgage credit intermediaries would be required to take out coverage levels that do not reflect the lower risk of claims to which they are exposed, with concomitant (but not necessarily proportional) increases in the insurance premiums. For the same reason, the proportionality criterion would not be met, as the burden imposed on intermediaries compared with other populations of similar professionals appears disproportionate.

Most importantly, the robustness criterion would not be met. The minimum PII amount for mortgage credit intermediaries would be pegged to a minimum level for another industry, which itself was calculated based on a methodology that is not necessarily robust. Furthermore, the methodology of the minimum PII amount is itself under periodic review and may therefore change over time, in ways that may not be appropriate for mortgage credit intermediation. As a result, the EBA does not consider option 2 to be desirable.

Option 3 would achieve a relatively high degree of feasibility, and an adequate but also low degree of methodological robustness. It is adequate because nothing better is available at this early inception stage, but it is also low, owing to the limited degree of representativeness of the country on which this amount is based. The degree of consumer protection achieved is lower than that achieved in options 2, 4 and probably also 1. Compliance costs for intermediaries would be low, as premium costs would be low and no additional reporting requirements would arise.

Compliance costs for NCAs would be low, too, at least for the Member States with existing PII requirements, which would not be required to change them. Costs would accrue to the other Member

States, but these costs would be the same as those accruing in options 2 and 4. The option would also be more proportionate than option 2 with regard to the comparative risk of exposure of mortgage credit compared with insurance intermediaries. Arguably, however, the resultant level is disproportionately too low, although it is not possible to support this statement with data. As a result, the EBA does not consider option 3 to be desirable.

Option 4 would achieve a high degree of feasibility (akin to that of option 3), and a degree of methodological robustness that is slightly higher than that of option 3, as the sample of countries includes jurisdictions (such as the Netherlands, Austria and the UK) that have the highest shares of intermediated mortgage sales across the 28 Member States in the EU¹³; a history of significant market penetration by mortgage intermediaries and, therefore, more developed approaches to regulating this sector. It is therefore methodologically not unreasonable to look towards these countries, even if they are few in number, for guidance on the most suitable regulatory approach to be taken. The degree of consumer protection achieved is higher than in option 3 but lower than in option 2 (EUR 1.2 million and EUR 1.68 million respectively), thus chiming with the hypothesis set out in option 2 that mortgage credit intermediaries pose a relatively lower risk. It is the second highest of all four options considered (subject to the assessment carried out for option 1).

Compliance costs for intermediaries would be lower than option 2 but higher than option 3. Compliance costs for NCAs would be higher, at least for the Member States with existing PII requirements that are set lower than, or differently from, those of option 4. However, as in options 2 and 3, the level would not be proportionate to the different degrees of risk between different mortgage credit intermediaries.

Of the four presented, the EBA considers option 4 to be the preferred option. Option 4 therefore constitutes the basis on which the EBA has drafted the RTS proposed to the Commission and set out in section 5.

6.2 Overview of questions for consultation

Q1: Do you agree that, of the four options presented, option 4 (i.e. setting the minimum amount at the average of the amounts used in Member States) is the option the EBA should pursue, resulting in a minimum amount of EUR 584 000 per claim, and EUR 886 000 per year?

Q2 Do you consider the number and the compensatable loss of compensation claims arising from the activity of mortgage intermediation to be lower than, the same as, or higher than those arising from insurance intermediation? Please explain your reasoning.

Q3: Do you know of options other than those listed in this consultation paper that the EBA should consider when deciding on the minimum amount of coverage?

Q4: Do you consider threshold(s) that distinguish between more than one minimum amount of PII coverage to be a desirable feature? If so, please explain how such a threshold should be devised.

¹³ Ibid, p. 96, 122.

6.3 Views of the Banking Stakeholder Group (BSG)

At the time of developing this policy proposal, the 2½-year term of the EBA's Banking Stakeholder Group (BSG) came to its scheduled end and a call for candidates for its second term had just been issued. The appointment, in autumn 2013, of the second cohort of the BSG, and the subsequent appointment of its Chair and the Chair of its consumer subgroup, was not completed by the time this consultation was finalised. Given the 6-month implementation deadline imposed by the MCD, the EBA decided not to wait for the new BSG cohort to be constituted.

Exceptionally, on this occasion, the BSG's views were therefore neither formally sought nor received. The EBA looks forward to receiving the BSG's feedback in response to the publication of this CP.