

EBA/CP/2015/16

12 October 2015

Consultation Paper on

The EBA benchmark rate under Annex II of the Mortgage Credit Directive (2014/17/EU)

Contents

1. Responding to this consultation	2
2. Executive Summary	3
3. Background and rationale	4
4. The EBA benchmark rate under Annex II of the Mortgage Credit Directive (2014/17/EU)	11
5. Accompanying documents	17
5.1 Draft cost-benefit analysis / impact assessment	17
5.2 Overview of questions for consultation	24

1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

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 the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 20.11.2015. 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 if 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) N° 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 under the Legal notice section of the EBA website.

2. Executive Summary

Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (the Mortgage Credit Directive or 'MCD') aims to develop a more transparent, efficient and competitive internal market, through consistent, flexible and fair credit agreements relating to immovable property, while promoting sustainable lending and borrowing and financial inclusion, and hence providing a high level of consumer protection.

More specifically, the MCD specifies the information that creditors should provide to consumers including personalised information in good time prior to the conclusion of the credit agreement in order to enable the consumer to compare and reflect on the characteristics of credit products. Creditors are required to provide this pre-contractual information to the consumer in the form of the European Standardised Information Sheet ('ESIS'). Part B of Annex II sets out instructions for creditors when completing the ESIS, including how to calculate the illustrative example of the annual percentage rate of charge (APRC) and the illustration of the instalment amount.

For both purposes, part B, Sections 4 and 6 of Annex II of the MCD specify that the creditor should calculate the illustrations using the highest level of a cap on the borrowing rate, or where there is no cap, the highest borrowing rate in at least the last 20 years or the longest period for which data is available, or "based on the highest value of any external reference rate used in calculating the borrowing rate where applicable or the highest value of a benchmark rate specified by a competent authority or EBA where the creditor does not use an external reference rate."

In this Consultation Paper, the EBA sets out its proposal for how the EBA rate should be calculated. Having assessed three different options against criteria such as availability of data; degree of representativeness for consumers; methodological robustness; compliance costs for financial institutions; and costs to the EBA; the EBA concludes that it should provide a formula that creditors have to use to calculate the rate. The formula uses an existing external reference rate as a key input. The EBA recognises that it may not be proportionate to require creditors to update the underlying rate on a daily basis and therefore stipulates that the rate is to be calculated once a year.

Next steps

The proposed EBA benchmark rate is published for the six weeks consultation period. The responses received during the consultation period will be taken into account when publishing the final EBA benchmark rate in the first quarter of 2016.

3. Background and rationale

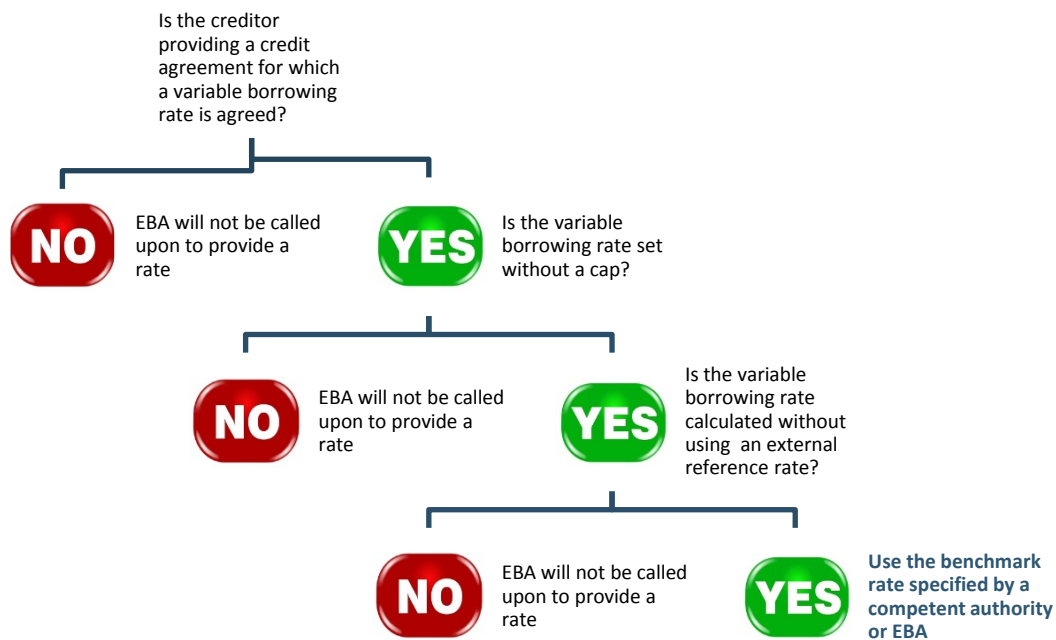
3.1 Background

1. Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (the Mortgage Credit Directive or 'MCD') was adopted on 4 February 2014 and published on 28 February 2014. The deadline for Member States to transpose the provisions of the MCD into national law is 21 March 2016.
2. The MCD aims to develop a more transparent, efficient and competitive internal market, through consistent, flexible and fair credit agreements relating to immovable property, while promoting sustainable lending and borrowing and financial inclusion, and hence providing a high level of consumer protection (Recital 6 MCD). To that end, the MCD specifies the information that creditors should provide to consumers. The MCD states in Recital 40 that the consumer should receive personalised information in good time prior to the conclusion of the credit agreement in order to enable the consumer to compare and reflect on the characteristics of credit products.
3. The MCD specifies further that personalised pre-contractual information should be provided by the creditor to the consumer so that the consumer can compare the credits available on the market, assess their implications and make an informed decision on whether to conclude a credit agreement. Article 14 MCD sets out the requirements for the pre-contractual information that should be provided to the consumer in the form of the European Standardised Information Sheet ('ESIS'). Furthermore, Part A, Annex II MCD sets out the model for the ESIS and specifies the text that should be included in the ESIS. Part B of the same annex sets out the instructions that should be as a minimum be followed when completing the ESIS.
4. Two of the categories of information that the creditor should provide to the consumer in the ESIS are information about the interest rate and other costs, and about the amount of each instalment (Sections 4 and 6 of the ESIS respectively). In Section 4 of the ESIS, the MCD provides that, if the mortgage features a variable rate, the creditor should provide an illustrative example to show the potential impact of rate variability on the Annual Percentage Rate of Charge ('APRC'). The illustrative example of the APRC shall accompany a warning that the variability of the borrowing rate could affect the actual level of the APRC. The MCD also provides that section 6 of the ESIS shall include an illustrative instalment amount which again shows the potential impact of the variability of the borrowing rate. The illustration of the instalment amount shall accompany a statement indicating that the borrowing rate is variable.
5. Part B Annex II MCD sets out the instructions for how the creditor should calculate the illustrative example of the APRC (Section 4(2)) and the illustration of the instalment amount (Section 6(4)). In both cases the MCD specifies that the creditor should calculate the illustrations using the highest level of a cap on the borrowing rate, or where there is no cap, the highest borrowing rate in at least the last 20 years or the longest period for which data is available, or "based on the

highest value of any external reference rate used in calculating the borrowing rate where applicable or the highest value of a benchmark rate specified by a competent authority or EBA where the creditor does not use an external reference rate.”

- The implication of these MCD provisions is that, from the transposition date of the MCD of 21 March 2016 onwards, the EBA may be called upon by creditors in the European Union to provide an EBA benchmark rate. Figure 1 illustrates the circumstances in which a creditor may rely on the EBA benchmark rate to produce the illustrations required in Annex II, MCD.

Figure 1: The circumstances in which a creditor may rely on the EBA benchmark rate



- As Figure 1 shows, an EBA benchmark rate will not be required by all creditors when creating the necessary illustrations in the ESIS. Rather, the EBA benchmark rate will only be required in specific circumstances, as a fall-back rate where other criteria have not been met.
- The EBA is hereby consulting publicly on its approach to producing the benchmark rate, including the underlying rate on which to base the rate. The EBA wishes to hear the views of stakeholders on whether the proposed benchmark rate will achieve the purpose stated in Annex II MCD and whether it succeeds in illustrating to consumers the potential variability of their borrowing rate.

3.2 Rationale

9. The EBA is not a rate-setting authority, and as such, has not previously specified a benchmark rate that can be used by creditors. Therefore, in order to be able to provide relevant creditors with a rate, the EBA must now develop a benchmark rate for the purposes foreseen in the MCD, i.e. to calculate the illustrative example of the APRC and the illustrative instalment amount for the ESIS.
10. The MCD does not, however, specify how the EBA should develop its benchmark rate or what that rate should be based on, i.e. the underlying rate. In deciding amongst various options on the most suitable approach to produce the required rate, the EBA first reflected on the purpose of the two illustrations in the ESIS, which is to illustrate to consumers the potential impact of the variability of the borrowing rate. In order to ensure that the purpose of the illustrations is achieved, the EBA benchmark rate should therefore be representative of the national experience of the variability of borrowing rates so that the illustrations will resonate with consumers.
11. The EBA identified three potential approaches to the benchmark rate foreseen in Annex II, MCD:
 - Option 1: Specify a single EBA benchmark rate that would be applicable in all Member States that do not specify their own rates. This would result in one generic rate for all relevant Member States;
 - Option 2: Specify a rate for each Member State that does not specify their own rate. The EBA would therefore specify an individual, bespoke rate for each Member State that does not specify its own national rate; or
 - Option 3: Specify the methodology from which creditors can calculate the rate themselves. The EBA would therefore not specify a rate but would instead specify the rate calculation methodology, i.e. a formula. The formula would require variable as opposed to fixed input, so creditors would have to input data themselves into the formula to create the benchmark rate. In addition, the methodology would rely on one specified underlying rate for each Member State, so in effect a rate would be produced that is bespoke for each Member State.
12. The EBA evaluated and assessed each option as follows:
 - Availability and reliability of the data to calculate the rate: the EBA would ideally want to use an underlying rate in each Member State that is reliable and for which historic data is readily available. All three of the options would facilitate such an approach.
 - Representativeness for consumers of the illustrations produced using the EBA benchmark rate: Option 1 will produce a single generic rate that cannot be representative for all Member States. The representativeness of Options 2 and 3 is higher than the 'one rate for all' option (Option 1) because they are based on a locally used underlying rate but the methods do not take account of the funding

costs and other costs that creditors include in the borrowing rates charged to consumers.

- Methodological robustness of the calculated rate: With Option 3 the EBA benchmark rate would always be up to-date because it should be calculated by creditors at the time when they need to use it. This would not be the case for Options 1 and 2 as the EBA benchmark rate would not be updated on a daily basis.
- Compliance costs for creditors and competent authorities that will accrue as a result of having to calculate the rate themselves: It is unlikely for any of the three options that creditors will incur additional costs over and above the costs that they will incur for calculating the illustrations.
- Costs for the EBA for developing and updating the rate: The costs for the EBA as a result of Option 3 will be less than other two options because with Options 1 and 2 the EBA would need to regularly update the benchmark rate whereas with Option 3 the formula will produce an up to date rate each time it is used. The formula will include 'built in' future proofing.

13. Given the assessment above, the EBA has concluded that it would be preferable to produce and publish a formula to calculate the EBA benchmark rate, rather than an actual rate, i.e. Option 3 is the most suitable option. It then considered how it would develop such a formula, including the underlying rate on which to base the EBA benchmark rate as well as the actual formula to calculate the rate.

3.2.1 Underlying rate

14. As the purpose of the EBA benchmark rate is to provide a rate in scenarios in which the creditor is not using an external reference rate, the time period for the underlying rate should mimic the time period set out in Annex II MCD (i.e. for scenarios in which a creditor is using an external reference rate). The implication would be that the EBA benchmark rate would be based on underlying rate for the 20 years before the ESIS is provided by the creditor to the consumer. However, if data on the underlying rate is only available for a period of less than 20 years, then the longest period for which such data is available should be used. In its formula the EBA will set the earliest start date of the 20 year period from the earliest date on which the underlying rate in all Member States is available. In doing so this will ensure that the EBA benchmark rate is calculated consistently across the European Union as the same historical time period will be used in all Member States.

15. As a next step the EBA considered various underlying rates to identify the most suitable option that would be used for the calculation of the EBA benchmark rate. The following evaluation criteria were considered by the EBA in identifying the suitable underlying rate:

- the underlying rate, including its historic data, should be easily available to creditors, for example, via a public website;

- the underlying rate should be reliable; and
- the underlying rate should be representative of the mortgage market in the respective Member State.

16. The EBA considered the suitability of two potential rates:

- **Rate Option 1:** Existing reference rates - for Eurozone Member States this would be the European Central Bank ('ECB') Main Refinancing rate; for non-Eurozone Member States this would be the national central bank refinancing rate or equivalent national central bank rate. Historic data for the ECB Main Refinancing rate is available from the ECB's website¹ from 1 January 1999. Similarly, historic data for the national central bank rates is available on the website of each national central bank in non-Eurozone Member States for more than 20 years; or
- **Rate Option 2:** Average variable mortgage rates - the ECB collects information from Member States (Eurozone and non-Eurozone) about average mortgage rates and collates and publishes this data on the website of the ECB's Statistical Data Warehouse. The ECB's Statistical Data Warehouse contains a number of rate categories under the heading of *A22 Lending for House Purchase*. The rate category "up to one year initial rate fixation" includes variable rates (where there was no initial fixed rate period)². This information is available for 31 countries but there are some gaps in the time series of data available for some Member States.

17. The EBA assessed each of the two rate options against the three evaluation criteria and concluded that rate option 1 – the use of an existing external reference rate – was the most suitable underlying rate, because it will produce an EBA benchmark rate in each Member State that will be representative of the local mortgage market and for which historic data is consistently available for all Member States.

18. As historic data on the ECB Main Refinancing Rate is only available from 1 January 1999, the EBA will set the earliest start date of the 20 year historic period from 1 January 1999 for the calculation of the EBA benchmark rate in all Member States. This means that a historic period of less than 20 years will apply when the EBA benchmark rate is calculated in the period from 2016 to 31 December 2018. Thereafter, historic rates will be available in all Member States for a period of 20 years. So, for example, if the EBA benchmark rate is calculated in 2016, the underlying rate will be sourced from the historic period 1999 to 2016, i.e. a 17 year historic period. Similarly if, for example, the rate is being calculated in 2020, the underlying rate will be sourced from the time period 2000 to 2020, i.e. a 20 year historic period.

19. The underlying rate to input into the formula to calculate the EBA benchmark rate will be the underlying rate applicable to the Member State in which the ESIS is provided to the consumer. For example, if the consumer is provided with the ESIS in Member State A but the mortgage

¹ <http://www.ecb.europa.eu/stats/monetary/rates/html/index.en.html>

² Paragraph 4 of Section 7.7.4,
<http://www.ecb.europa.eu/pub/pdf/other/mfiintrestatisticsmanualen.pdf?a0198ee1f9e0fa650ec38504f4ab6470>

offered to the consumer is denominated in the currency of Member State B, then the relevant underlying rate to input into the formula to calculate the EBA benchmark rate is the underlying rate of Member State A. Similarly if, for example, the ESIS is provided to the consumer in Member State A but the creditor offering the mortgage to the consumer is passporting into Member State A from Member State B on a freedom to provide services basis then the relevant underlying rate to input into the EBA formula is the underlying rate of Member State A. In all cases the relevant underlying rate is the underlying rate of the Member State in which the ESIS is provided to the consumer.

3.2.2 Formula to calculate the EBA benchmark rate

20. After the EBA identified the most suitable underlying rate on which to base the EBA benchmark rate, it then considered options for the formula to calculate the EBA benchmark rate. In developing the formula, the EBA again reflected on the purpose of the MCD reference to an EBA benchmark rate, i.e. that it will be used to calculate illustrations to show the consumer the potential impact of the variability of the borrowing rate. The EBA also considered that the formula to calculate the EBA benchmark rate should be simple, straightforward and easy for creditors to use.

21. The EBA considered two potential options for a formula:

- **Option 1:** EBA benchmark rate = the highest value of the ECB Main Refinancing rate or the national central bank refinancing rate (or equivalent national central bank rate) in the 20 year period (or the maximum period available) prior to the date of provision of the ESIS to the consumer PLUS the borrowing rate applicable during the longest period known at the time of the provision of the ESIS; or
- **Option 2:** EBA benchmark rate = (the highest value of the ECB Main Refinancing rate or the national central bank refinancing rate (or equivalent national central bank rate) in the 20 year period (or the maximum period available) prior to the date of provision of the ESIS to the consumer MINUS the lowest value of ECB Main Refinancing rate, the national central bank refinancing rate (or equivalent national central bank rate)) PLUS the borrowing rate applicable during the longest period known at the time of the provision of the ESIS.

22. Having assessed the two options against the criteria of simplicity, straightforwardness and ease of use, the EBA concluded that option 2 is the most suitable formula to calculate the EBA benchmark rate, because the degree of representativeness of option 2 is higher due to the fact that by also taking account of the lowest underlying rate in the past 20 years it acknowledges that the borrowing rate will in part reflect funding costs (which the refinancing rate information is a proxy for).

23. The EBA also recognised that, while the formula requires that the underlying rate is sourced for a period of 20 years prior to the date on which the ESIS is provided to the consumer (or for the duration that the data has been available if less than 20 years), it may not be proportionate for creditors to update the underlying rate each day as foreseen by the draft formula. Therefore the

EBA considers that it is reasonable that creditors may recalculate the formula for the figures to be used in the ESIS once every year rather than having to revisit the formula on a daily basis.

24. In order to ensure that, within each Member State, creditors use the same difference between the highest and the lowest values of the underlying rate, this calculation should be done on the same day. In order to ensure that the values of the underlying date collected to be used in the calculations are aligned with its start date of 1 January 1999, the EBA considers that the calculation should be done at the first working day of each year.

4. The EBA benchmark rate under Annex II of the Mortgage Credit Directive (2014/17/EU)

In between the draft text that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

EBA/20XX/XX

DD Month YYYY

The EBA benchmark rate under Annex II of the Mortgage Credit Directive (2014/17/EU)

The EBA benchmark rate under Annex II of the Mortgage Credit Directive (2014/17/EU)

1. This document sets out the benchmark rate specified by the EBA referred to in Part B, Section 4, paragraph (2) and Section 6, paragraph (4) of Annex II of Directive 2014/17/EU³ (“EBA benchmark rate”).
2. The EBA benchmark rate is to be used by creditors to calculate the illustrative example of the Annual Percentage Rate of Charge (APRC) and the illustration of a maximum instalment amount respectively, under the conditions set out in those paragraphs and for inclusion in Section 4 and Section 6 of the European Standardised Information Sheet (“ESIS”) as referred to in Annex II of Directive 2014/17/EU.
3. The EBA benchmark rate shall apply only where the competent authority of the Member State has not specified a benchmark rate.
4. The formula to calculate the EBA benchmark rate is:

$$EBA \text{ benchmark rate} = (HR - LR) + BR$$

For credit agreements for which the ESIS is provided in Member States that have the Euro as their currency:

HR = the highest value of the ECB Main Refinancing rate in the 20 year period (or the maximum period available if shorter) prior to the date that the creditor shall calculate the difference of (HR-LR) to be used in the formula as set out in paragraphs 6 and 7.

LR = the lowest value of the ECB Main Refinancing rate in the 20 year period (or the maximum period available if shorter) prior to the date that the creditor shall calculate the difference of (HR-LR) to be used in the formula as set out in paragraphs 6 and 7.

BR = the borrowing rate applicable to the credit agreement during the longest period known at the time of the provision of the ESIS.

For credit agreements for which the ESIS is provided in other Member States:

³ Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.02.2014, p.34).

HR = the highest value of the national central bank refinancing rate (or equivalent national central bank rate) in the 20 year period (or the maximum period available if shorter) prior to the date that the creditor shall calculate the difference of (HR-LR) to be used in the formula as set out in paragraphs 6 and 7.

LR = the lowest value of the national central bank refinancing rate (or equivalent national central bank rate) in the 20 year period (or the maximum period available if shorter) prior to the date that the creditor shall calculate the difference of (HR-LR) to be used in the formula as set out in paragraphs 6 and 7.

BR = the borrowing rate applicable to the credit agreement during the longest period known at the time of the provision of the ESIS.

5. The 20 year period prior to the provision of the ESIS to the consumer shall begin, at the earliest, on 1 January 1999.
6. The calculation of (HR-LR) shall be carried out once every calendar year, on its first working day, with the exception of the year of the entry into force of the MCD, when the calculation shall be carried out on 21 March 2016. The calculation shall be used for the ESISs provided to consumers during the same calendar year.
7. The variables HR and LR are based on the underlying rates that apply in the Member State in which the creditor provides the ESIS to the consumer.

HR and LR – the relevant national central bank refinancing rates or equivalent rates

8. For the purposes of calculating the EBA benchmark rate for an ESIS provided in Member State, which has a currency other than the Euro, the national central bank refinancing rates or equivalent national central bank rates are as follows, as at October 2015:

Member State	Name of the relevant national central bank rate as at October 2015
Bulgaria	Bulgarian National Bank Base Rate
Czech Republic	Czech National Bank Repo Rate
Denmark	Danmarks Nationalbank Reference Rate
Croatia	Croatian National Bank Lombard Rate
Hungary	The Central Bank of Hungary Central Bank Base Rate

Poland Narodowy Bank Polski Reference Rate

Romania Banca Națională a României Monetary Policy Rate

Sweden Sveriges Riksbank Reference Rate

United Kingdom Bank of England Official Bank Rate

Examples of the application of the formula for the Consultation Paper

To assist stakeholders in their consideration of the EBA formula, the EBA has created two examples to illustrate how the formula would be used in practice.

Example of the formula used by a creditor in a Eurozone Member State

EBA benchmark rate = $(HR - LR) + BR$

HR = the highest value of the ECB Main Refinancing rate since 1 January 1999, i.e. 4.75% at the date of publication

LR = the lowest value of the ECB Main Refinancing rate since 1 January 1999, i.e. 0.05% at the date of publication

BR = the borrowing rate applicable to the credit agreement for the duration of the credit agreement = 3.00%

EBA benchmark rate = $(4.75\% - 0.05\%) + 3.00\% = 7.70\%$

Example of the formula used by a creditor in a Eurozone Member State where the credit agreement includes an initial discount (of 1.00%) off the variable borrowing rate (of 3.00%)

EBA benchmark rate = $(HR - LR) + BR$

HR = the highest value of the ECB Main Refinancing rate since 1 January 1999, i.e. 4.75% at the date of publication

LR = the lowest value of the ECB Main Refinancing rate since 1 January 1999, i.e. 0.05% at the date of publication

BR \neq the discounted variable borrowing rate (of 2.00%). Instead BR = the borrowing rate applicable to the credit agreement during the longest period known at the time of the provision of the ESIS = 3.00%

EBA benchmark rate = $(4.75\% - 0.05\%) + 3.00\% = 7.70\%$

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

A. Problem identification and baseline scenario

25. The MCD requires under specific circumstances that creditors use an EBA benchmark rate for the purpose of calculating the illustrative example of the APRC and the illustrative instalment amount for the ESIS. As the EBA has not already specified a benchmark rate, it must develop a new EBA benchmark rate that can be used by creditors specifically and only for the purposes foreseen in the MCD. The MCD does not, however, specify how the EBA should develop its benchmark rate or what that rate should be based on. The EBA must therefore identify and evaluate how best to develop its benchmark rate.

B. Policy objectives

26. At high level, in publishing its benchmark rate the EBA aims at contributing to the development of a more transparent, efficient and competitive internal market, through consistent, flexible and fair credit agreements relating to immovable property. In line with Recital 6 MCD, the general objective is promoting sustainable lending and borrowing and financial inclusion, and hence providing a high level of consumer protection.

27. To that end, the MCD specifies the information that creditors should provide to consumers. The MCD states in Recital 40 that the consumer should receive personalised information in good time prior to the conclusion of the credit agreement in order to enable the consumer to compare and reflect on the characteristics of credit products. The MCD specifies further that personalised pre-contractual information should be provided by the creditor to the consumer so that the consumer can compare the credits available on the market, assess their implications and make an informed decision on whether to conclude a credit agreement.

28. In order to ensure that the purpose of the illustrations is achieved, the EBA benchmark rate should therefore be representative of the national experience of the variability of borrowing rates so that the illustrations will resonate with consumers. Further, the technical criteria for the EBA benchmark and the underlying data and / or calculation formulae are their availability, reliability, representativeness and methodological robustness.

C. Options considered and Cost-Benefit Analysis

29. The EBA identified three potential approaches to the benchmark rate foreseen in Annex II, MCD:

- Option 1.1: Specify a single EBA benchmark rate that would be applicable in all Member States that do not specify their own rates. This would result in one generic rate for all relevant Member States;
- Option 1.2: Specify a rate for each Member State that does not specify their own rate. The EBA would therefore specify an individual, bespoke rate for each Member State that does not specify its own national rate; or
- Option 1.3: Specify the methodology from which creditors can calculate the rate themselves. The EBA would therefore not specify a rate but would instead specify the rate calculation methodology, i.e. a formula. The formula would require variable as opposed to fixed input, so creditors would have to input data themselves into the formula to create the benchmark rate. In addition, the methodology would rely on one specified underlying rate for each Member State, so in effect a rate would be produced that is bespoke for each Member State.

30. The EBA evaluated each option against the following assessment criteria:

- Availability and reliability of the data to calculate the rate;
- Representativeness for consumers of the illustrative example of the APRC that is produced by creditors using the EBA rate;
- Methodological robustness of the calculated rate;
- Compliance costs for creditors and competent authorities that will accrue as a result of having to use the rate specified by the EBA or calculating the rate themselves; and
- Costs for the EBA to develop and update the rate.

31. The EBA concluded that Option 1.3, to publish the formula to calculate the EBA benchmark rate, was the most suitable approach based on the following assessment of each of the three options:

- Availability and reliability of the data to calculate the rate: For all three options the EBA can choose an underlying rate in each Member State that is reliable and for which historic data is readily available.
- Representativeness for consumers of the illustrations produced using the EBA benchmark rate: Option 1.1 will produce a single generic rate that cannot be representative for all Member States. The representativeness of Options 1.2 and 1.3 is higher than the 'one rate for all' option (Option 1.1) because they are based on a locally used underlying rate but the methods do not take account of the

funding costs and other costs that creditors include in the borrowing rates charged to consumers.

- Methodological robustness of the calculated rate: By publishing the formula to calculate the rate the EBA can ensure that the benchmark rate is always up to date as it should be calculated by creditors at the time when they need to use it. This would not be the case for Options 1.1 and 1.2 as the EBA benchmark rate would not be updated on a daily basis.
- Compliance costs for creditors and competent authorities that will accrue as a result of calculating the rate themselves: It is unlikely for any of the three options that creditors will incur additional costs over and above the costs that they will incur for calculating the illustrations.
- Costs for the EBA for developing and updating the rate: The costs for the EBA as a result of Option 3 will be less than other two options because with Options 1.1 and 1.2 the EBA would need to regularly update the benchmark rate whereas with Option 1.3 the formula will produce an up to date rate each time it is used. The formula will include 'built in' future proofing.

32. Once the EBA decided that it would develop a formula from which creditors could calculate the EBA benchmark rate, it then considered what underlying rate should be input into the formula and the historic period for that underlying rate.

33. Regarding the historic period for the underlying rate, the EBA considered that a 20 year historic period is appropriate because this period mimics the time period set out in Annex II MCD where a creditor is using an external reference rate. In effect this would mean that the EBA benchmark rate would be based on underlying rate for the 20 year period before the ESIS is provided by the creditor to the consumer or the longest period for which data is available. The EBA will set the earliest start date of the 20 year period from the earliest date on which the underlying rate in all Member States is available. In doing so this will ensure that the EBA benchmark rate is calculated consistently across the European Union as the same historical time period will be used in all Member States.

34. The EBA considered two rates for their suitability as the underlying rate to calculate the benchmark rate:

- Option 2.1: Central Bank interest rate - for Eurozone Member States this would be the ECB Main Refinancing rate; for non-Eurozone Member States this would be the national central bank refinancing rate or equivalent national central bank rate; or
- Option 2.2: Average variable mortgage rates - the ECB collects information from Member States (Eurozone and non-Eurozone) about average mortgage rates and collates and publishes this data on the website of the ECB's Statistical Data

Warehouse. The ECB's Statistical Data Warehouse contains a number of rate categories under the heading of A22 Lending for House Purchase. According to the Manual on MFI interest rate statistics, Regulation ECB/2001/18, December 2003⁴, variable rates (where there was no initial fixed rate period) are included in the rate category "up to one year initial rate fixation". This information is available for 31 countries.

35. The EBA assessed each of the two rate options against the following evaluation criteria:

- the rate (including historic data) should be easily available to creditors, for example, via a public website;
- the rate should be reliable; and
- the representativeness of the rate to mortgage markets in each Member State.

36. The EBA concluded that Option 2.1, to use Central Bank interest rates (for main refinancing operations), was the most suitable underlying rate to use. The EBA analysis and conclusion is set out in Table 1, and supported in Table 2.

37. In addition, as the historic data on the ECB main re-financing rate is available from 1 January 1999, the earliest date from which the 20 year historic period will commence will be set at 1 January 1999 for the calculation of the EBA benchmark rate in all Member States.

⁴ Paragraph 4 of Section 7.7.4,
<http://www.ecb.europa.eu/pub/pdf/other/mfiintrestatisticsmanualen.pdf?a0198ee1f9e0fa650ec38504f4ab6470>



Table 1. Assessment of the underlying rate options

Evaluation criteria	Option 2.1	Option 2.2	Overall assessment
A – historic data availability	Historic data is publicly available on the ECB refinancing rate for the period 1 January 1999 to date. Historic data is also easily available on the national central banks' base rates for non-Eurozone Member States.	The ECB Data Statistical Warehouse Monetary Financial Institution interest rate statistics (MFI interest rate statistics) contains historic data of the average variable mortgage interest rates for Member States. The earliest date from which data is available is January 2003 (for 13 Member States). In addition, there are gaps in the time series for data available for nine Member States, in one Member State there is a gap of approximately five years. Also, there is no data available for 1 Member State under the category “up to one year initial rate fixation” where variable rates are situated.	In terms of the availability of historic data, this data is available consistently for the rates outlined in Option 2.1 but for Option 2.2 there are gaps in the time series for available data for 11 Member States. The gaps in the time series for 11 Member States in Option 2.2 may impact on the representativeness of the illustrations that would be produced using the rates in Option 2.2. Therefore based on this evaluation criterion Option 2.1 is more suitable.
B – reliability	The ECB refinancing rate and the national central banks' base rates are commonly perceived to be reliable and of good repute.	The data is collected by national central banks and collated by the ECB Data Statistical Warehouse. This data is therefore commonly perceived to be reliable and of good repute.	Both rate options can be considered to be reliable and of good repute.
C – market representativeness	To determine if the ECB refinancing rate or the national central banks' refinancing rates for non-Eurozone MS can be considered as representative of the mortgage markets the EBA completed a comparison of the highest ECB refinancing rate or the national central banks' refinancing rates for non-Eurozone MS against the variability (highest rate minus lowest rate) of the average variable mortgage rates in each MS. This is set out in Table 2 below.	The data is based on interest rates that are individually agreed between the borrower and the lending bank ⁵ and are then collected by national central banks and collated by the ECB. The data in this option is, therefore, representative of mortgage markets in each Member State because this data represents the average mortgage rate on outstanding amounts for each Member State.	The Option 2.2 appears to be more representative of individual mortgage markets than the Option 2.1. Nevertheless, the Option 2.1 would also be representative, since in 24 Member States the highest ECB refinancing rate or equivalent national central bank rate for the 20 year period to 21 March 2016 (or the period since 1999 for the ECB rate) is higher than the difference between the lowest and highest average mortgage rate in the Member State in the historic periods for which this data is available ⁶ . For example, if the highest ECB or central bank rate was added to the lowest average mortgage rate, it would illustrate to the consumer the potential variability of the interest rate based on the past experience of interest rates.

⁵ http://www.ecb.europa.eu/stats/pdf/mir_general_description.pdf?245542ed13f5a99aa996609a06ce0814

⁶ 2003 is the earliest date from which the average mortgage rates are available from the ECB Data Statistical Warehouse.

38. The EBA considered two potential formulae:

- a) **Option 3.1:** EBA benchmark rate = the highest value of the ECB Main Refinancing rate or the national central bank refinancing rate (or equivalent national central bank rate) in the 20 year period (or the maximum period available) prior to the date of issue of the ESIS to the consumer PLUS the borrowing rate applicable during the longest period known at the time of the provision of the ESIS; or
- b) **Option 3.2:** EBA benchmark rate = (the highest value of the ECB Main Refinancing rate or the national central bank refinancing rate (or equivalent national central bank rate) in the 20 year period (or the maximum period available) prior to the date of issue of the ESIS to the consumer MINUS the lowest value of ECB Main Refinancing rate, the national central bank refinancing rate (or equivalent national central bank rate) PLUS the borrowing rate applicable during the longest period known at the time of the provision of the ESIS.

39. Both formulae require the creditor to add the borrowing rate that will apply to the consumer's agreement and thus the EBA benchmark rate produced will include the funding costs and other applicable criteria to determine the borrowing rate in the first place. This ensures that the EBA benchmark rate will represent each consumer's borrowing rate.

40. Both formulae take account of the highest underlying rate in the last 20 years (or maximum period available) and as a result the benchmark rate produced will illustrate the highest mortgage rates in Member States in the last 20 years. The representativeness of the EBA benchmark rate produced by the formula under Option 3.2 is increased because the second formula also takes account of the lowest underlying rate in the past 20 years. As a result the second formula may be more precise than the first formula because it considers that an element of the underlying rate may also be included in the borrowing rate and therefore eliminates the possibility of including that twice in the formula.

41. Based on this assessment the EBA concluded that Option 3.2 is the most suitable formula to calculate the EBA benchmark rate.

42. In addition, to ensure that all illustrations in a Member State that are calculated using the EBA benchmark rate will consistently reflect the rate experience in that Member State, the EBA requires that the underlying rates input into the formula are those applicable to the market of the Member State in which the creditor is providing the ESIS to the consumer.

5.2 Overview of questions for consultation

Question 1: Do you agree with the EBA's approach to deliver the EBA benchmark rate by publishing a formula from which creditors can calculate the rate? If not, outline why you disagree and suggest an alternative approach including the reasons for the suggestion.

Question 2: Do you agree with the proposed EBA formula? If not, outline why you disagree and specify how the formula could be improved.

Question 3: Do you agree with the underlying rate to be input into the proposed EBA formula? If not, outline why you disagree and suggest alternative rate, including the reasons for the suggestion.