Financial Services User Group (FSUG)

Brussels, 12.02.2015

FSUG Response on Consultation on EBA/CP/2014/43 on "Draft Guidelines on arrears and foreclosure"

About FSUG

The Financial Services User Group (FSUG) is an expert group set up by the European Commission following the core objective "to secure high quality expert input to the Commission's financial services initiatives from representatives of financial services users and from individual financial services experts". The mandate of the group is to:

- advise the Commission in the context of the preparation of legislative acts or other policy initiatives affecting users of financial services, including consumers, retail investors and micro-enterprises;
- provide insight, opinion and advice concerning the practical implementation of such policies;
- proactively seek to identify key financial services issues which affect users of financial services;
- where appropriate, and in agreement with the Commission, liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level, as well as to other consultative groups administered by the Commission, such as the European Consumer Consultative Group, the Payment Systems Market Expert Group, the European Securities Markets Expert Group and the Expert Group on Financial Education.

General comments[1]

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

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

The guidelines provide detail on how financial institutions should give effect to the relevant MCD provisions in Article 28, and thus contribute to the EBA's objective of achieving a

[1] Discussions with members of the EBA Banking Stakeholder Group (BSG) are gratefully acknowledged.

convergence of supervisory practices for the Directives that fall into the EBA's scope of action. The Guidelines establish requirements on policies and procedures; engagement with the consumer; provision of information and assistance to the consumer; resolution process; and documentation of dealings with the consumer and retention of records.

The Financial Services User Group ("FSUG") welcomes the opportunity to comment on the Consultation Paper 2014/43 on Draft Guidelines on arrears and foreclosure.

The guidelines have the merit to set out the minimum requirements and measures to be implemented by creditors. However, as they are very few detailed, especially when compared with the codes adopted by national authorities (see for example Portugal, UK, and Ireland), we have some doubts as regards their effectiveness.

As a very important principle, the FSUG considers essential that the mechanisms created to deal with arrears do not lead to a situation more unfavorable to the consumer than that existing. On the contrary, the FSUG proposes that the EBA should introduce solutions to ensure that consumers are effectively protected.

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

National supervising authorities should regulary monitor the application of these guidelines into practice and report to the EBA on the findings. On the basis of this reporting, the EBA should evaluate whether more extensive guidelines or more binding rules are needed.

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

1. Establishment of policies and procedures

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

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

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

1.4 The creditor should review these policies and procedures regularly.

The FSUG supports the above requirements, but considers that the guidelines should go further.

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

- if indexes used in all variable rate mortgage loans rise, and
- if exchange rates of foreign currency loans rise.

As regards foreign currency loans, as it is mentioned in Article 23 (4) of the MCD, Member States shall ensure that the creditors warn the consumers on a regular basis, but at least where the value of the total amount payable by the consumer which remains outstanding or of the regular instalments varies by more than 20% from what it would be if the exchange rate between the currency of the credit agreement and the currency of the Member State applicable at the time of the conclusion of the credit agreement were applied.

It should be also strictly forbidden to lend money to debtors in an irresponsible manner, which will make them over-indebted shortly after the signing of the credit agreement.

This was unfortunately the case before the crisis in some Member States[2] where consumers were tempted with loans with a relatively low fixed introductory interest rate for 3, 6 or 12 months, and after this period the interest rate has risen to very high levels (sometimes double or even more comparing with the initial one).

At the same time, the debt-to-income ratio (calculated as a share of debt service to total disposable income) had sharply increased by banks until 65%-70%. As a result, in a very short time, many consumers became over-indebted, without any chances to pay their debt in time. It was also the crisis that hit them soon, and their revenues decreased also, together with the prices of immovable properties (the prices of houses have decreased with 50% or even more because it was an asset bubble before the crisis).

Please also note that because the rate of interest for the local currency was very high compared to foreign currencies, the vast majority of the loans approved before the crisis[3] were disbursed in foreign currencies. And also the exchange rates sharply increased[4].

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

Creditors should develop information relating to impairment and a performance tracking system to proactively segment their pre-arrears population. They should consider which borrowers are most likely to be affected by potential rate rises, for example, those who have experienced payment problems in the past or those with a high debt-to-income ratio, and consider deploying proactive strategies to engage them at the earliest moment possible. While monitoring the consumer's financial situation, the creditors should respect his privacy and data protection rights.

Creditors should put in place tools to detect and act upon 'early warning signs' such as borrowers consolidating debt or failing to meet all of their financial commitments. This would allow them to develop effective early engagement strategies and offer proactive solutions or

[2] For instance, Romania and other Central and Eastern European Member States
[3] In Romania, the percent was about 70% of the total loans disbursed before the crisis
[4] Comparing with the middle of year 2007, when was the best moment for RON, now (end of January 2015) the exchange rate has increased with about 250% for CHF/RON and with about 40% for EUR/RON.

money advices which increase the chance of better outcomes for both customers and creditors.

We propose that a common definition of alerts be introduced that might provide for situations of risk of failure, as it exists in Portugal with the Action Plan for the Risk of Failure (PARI).

Senior management should have the duty to promote cultures in arrears management functions which focus on delivering outcomes aligned with the best interests of customers. Management need to provide leadership and direction to create an environment that enables their staff to make informed judgments, and take decisions that reflect the specific personal and financial circumstances of individual borrowers. They must ensure that decisions around forbearance or repossession are suitable given the specific personal and financial circumstances of borrowers - dealing sensitively with borrowers who may have particular vulnerabilities. Decisions should take account of a borrower's likely long-term ability to repay their arrears.

More efforts need to be done on the preventive side to avoid consumers from falling into arrears in the first place. These measures should include flexibility in the loan repayment (for instance, if the consumer has a momentary spike in revenue or extra financial means, repay a larger amount of the loan to secure the possibility to delay the payment of an instalment at no cost should his financial situation change for the worse).

Providers should be asked to stop passing market risks on to consumers and offer affordable fixed interest loans to their customers. It is disappointing that in the EU most risky loans are sold in Member States where consumers are most vulnerable (new Member States, Southern and Eastern Europe).

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

Points 1.2 and 1.3 - The following text should be added at the end of the sentence: ".... *or expected payment difficulties*".

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

2. Engagement with the consumer

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

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

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

The FSUG supports the above requirements but that they should go further.

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

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

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

Creditors should engage sensitively with borrowers who have specific needs or circumstances which are likely to limit their ability to engage effectively, for example, customers dealing with bereavement or terminal illness, or those with physical and mental health issues (this is not an exhaustive list).

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

It is very important to be sure that fundamental rights as human dignity, privacy, safety, health etc. are respected by creditors and any other agents acting on behalf of creditors. Debt enforcement should respect the privacy of the debtors and not share any information with friends/ neighbors/relatives/colleagues. Any violent language or harassment that may lead to physical or psychological harm must be prevented. Debt enforcement could cause illness or exacerbate some existing health problems. There needs to be assurances that debtors, especially the vulnerable ones, are treated sensitively and appropriately[5].

There are many examples in practice of consumers being harassed by representatives of creditors, especially by employees working for debt collectors[6]. It would be very important to include into the guidelines, at the end of point 2.3, a clear mention to discourage such practices.

3. Provision of information and assistance to the consumer

3.1 The creditor should have a consumer engagement policy in place. This should ensure that they provide adequate information, for example, through websites and written materials, and support for consumers in, or concerned about, payment difficulties.

3.2 The creditor should communicate clearly and in plain language.

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

a) the number of payments either missed or only paid in part;

b) the total sum of the payment shortfall;

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

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

c) the charges incurred as a result of the payment shortfall;

d) the importance of the consumer co-operating with the creditor to resolve the situation.

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

a) information regarding the consequences of missing payments (e.g. costs, default interest rate, possible loss of property, etc.); and

b) information about available government/public schemes or support.

The FSUG supports the above requirements, but recommends that they should go further.

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

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

As regards fees and charges, charging practices should be fair and only reflect the additional resources required to administer the cases, on which such charges should be based.

4. Resolution process

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

Concessions to the consumer include:

1. a total or partial refinancing of a credit agreement; and/or

2. a modification of the previous terms and conditions of a credit agreement, which may include amongst others:

a) extend the term of the mortgage;

b) change the type of the mortgage;

c) defer payment of all or part of the instalment repayment for a period;

d) change the interest rate;

e) offer a payment holiday.

The FSUG supports the above requirements which it recommends need to be more detailed.

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

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

The borrower should be granted a series of guarantees. Among these, the creditors should be prohibited from terminating credit agreements, bringing legal proceedings against household customers with a view to redeeming credits or assigning the said credits to third parties.

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

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

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

Financial institutions should also actively engage in cooperating with social services and other actors as the situation a consumer faces can require tailored responses that require the successful cooperation of multiple actors. It is pointless for social services to try to help a consumer get back into employment while at the same time creditors push harsh foreclosure and debt recovery procedures.

Lenders should be also encouraged to include in their mortgage contracts a clause allowing the borrower to modify the amount of his monthly repayment; this clause could provide for a minimum monthly payment below which it would not be possible to go down, and eventually a maximum monthly payment (to be used in case of increase of income - relevant in particular for independent workers who have irregular income). Once a year, the borrower could inform his bank of his choice to lower or increase monthly payments, which would allow him to more easily manage decrease of income due to divorce, jobless for instance, or increase of his expenses.

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

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

As it is clearly mentioned in the MCD that “Member States shall not prevent the parties to a credit agreement from expressly agreeing that return or transfer to the creditor of the security or proceeds from the sale of the security is sufficient to repay the credit”, the FSUG considers mandatory to include a new point (5): datio in solutum – borrowers who cannot repay their mortgage are released in full from the outstanding debt by handling their mortgage property over to the lender.

In our view, which is in line with the main conclusion on this issue of a study prepared for FSUG by London Economics in December 2012, where the consumer is informed that the lender wishes to move to foreclosure, just after being able to evidence its efforts to agree and deliver a viable restructuring and the borrower’s failure to comply with this, all consumers, irrespective of income, should be able to apply for datio in solutum immediately[7].

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

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

The FSUG support the above requirements.

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

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

Please see our response at Question 1.

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