

## Progress towards a single European market for mortgage credit

By Geoffrey Fitchew

In the European Commission our first objective in progressing towards a single European market in banking and other financial services is to create more competition, efficiency and innovation in the sector. This will ensure that it is better equipped to compete in a market counting over 320 million consumers and to face the American and Japanese challenge on a global level.

The way forward to achieve this objective is through the creation of the single European market in banking services. What we are trying to accomplish is that it will be as easy for any duly authorised bank to set up branches anywhere in the Community as it is in its home Member State. And it should be as easy for that bank to provide its whole range of services in other Member States, without having a branch or another kind of permanent establishment, as it is for it to provide its services in its home market.

The removal of restrictions on these freedoms of establishment and provision of services, which are an essential part of the Treaty of Rome, has been helped by clear decisions of the Court of Justice of the European Communities since its landmark Van Binsbergen case in 1974, and is now, at last, within reach.

Our second objective is that the single market should be achieved without any lowering of prudential standards and, indeed, that average standards should rise in order to protect depositors and the overall stability of the banking system.

Heavier competition will naturally entail greater risks.

The Commission's strategy to complete the Internal Market was set out in its White Paper in 1985. Our approach to achieving the objectives for the banking sector centres on three important points:

- the complete freedom of capital movement;
- minimum pre-requisite harmonisation of supervisory standards to ensure mutual recognition and the acceptance of home-country control;
- a single banking licence for setting up a branch and providing services anywhere in the Community.

### *Necessary legislation*

As far as the legislation designed to secure these advances is concerned, the foundation for the specific banking legislation — the directive com-

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*'320 million consumers'*

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pleting the liberalisation of capital movements — was agreed by the Council in June of this year. One of its most important features is the agreement to liberalise all remaining short-term transactions, financial loans and credits and investments in securities.

This is clearly a pre-requisite for completing a unified banking market in the Community, but not adequate

in itself to secure free access for banks and mortgage credit institutions to market and advertise their services throughout Europe, nor to ensure adequate protection for savers and depositors.

### *Second banking directive*

The specific banking legislation necessary to secure free access with adequate safeguards is based on the principles of home-country supervisory control, and the mutual recognition of national supervisory systems in the Community. These principles are acceptable only if there is a certain minimum harmonisation of supervisory standards in all 12 Member States.

Our proposal for a Second Banking Co-ordination Directive is the cornerstone of Commission efforts to create a single European market in the banking sector on the basis of the principles I have mentioned.

The Commission's approach to the banking sector is an all-embracing one, in the sense that EEC legislation will relate not only to commercial and investment banks, but also to savings banks, co-operative banks, building societies, mortgage banks and other specialist banks. The definition of a "credit institution" in Community legislation is that it should take deposits and grant credits. So you will see that the ambitious new freedoms that are envisaged in the banking sector are being offered to a wide range of institutions.

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supervision of these institutions can be seen as reflecting a clear trend of increasing contact between the national supervisory authorities in the eighties. According to our proposals, branches of Community credit institutions operating in other Member States, newly liberated from the requirements of separate authorisation, endowment capital and the obligation to provide branch accounts, will be subject to prudential supervision only by the authorities in their parents' home country.

The supervision of liquidity and market risk in respect of open positions in tradeable securities are seen as temporary exceptions to this general principle, but the central

## 'Home country supervision'

theme of the new freedoms proposed under the Second Directive is that home-country supervisors retain primary responsibility for the European-wide activities of banks which they have authorised, whether that business is conducted through branches in other Member States or supplied as a service into another country. This system will, of course, be operated by the individual banking supervisors in the Member States.

### Minimum supervisory standards

At the same time, and as a prerequisite for acceptance of the system of home-country control, those supervisors have requested a minimum harmonisation of specific prudential standards relating to credit institutions in the Community. In this sense, the Second Directive forms part of a linked package with four other proposals, covering:

- an agreed definition of own funds;
- a harmonised solvency ratio;
- treatment of large exposures;
- deposit guarantee schemes,

designed to achieve a level playing field.

The question of a supervisory

definition of own funds is the subject of a proposal for a directive which is at an advanced stage of discussion in a Council working group. The general approach, on which broad agreement has been reached, is very similar to that arrived at in the Basle Supervisors' Committee of the Group of 10 countries. The definition of own funds finally agreed in the Council will form the numerator of a solvency ratio applicable to Community credit institutions.

The proposal for a directive on solvency ratio was transmitted to the Council in June. It applies a ratio, which has provisionally been set at 8%, and which relates assets and off-balance sheet items, adjusted to reflect varying degrees of *credit* risks, to the own funds available to meet such risks.

The introduction of a risk-weighted solvency ratio will clearly have an impact on the position of institutions and the pricing of different financial instruments and services. This is a matter about which the European Federation of Building Societies and the European Mortgage Federation have expressed concern in the past.

In particular, the solvency ratio proposal's restriction on "loans for the purchase of residential property for their own occupation" was considered too narrow. The outcome of the Basle Supervisors' Committee work on a capital adequacy framework incorporates a somewhat wider definition on this point, in particular to allow for rented property.

Although the matter is still under debate in Brussels, the Commission has always stressed the need for compatibility between the Basle proposals and the EEC Directives. In this light, I can say that the Commission would expect that the definition in the solvency ratio proposal will be widened accordingly.

The two final matters on which we believe there should be a measure of harmonisation are *large exposures* (risk concentration), both on- and off-

balance sheet, run by Community credit institutions, and *deposit guarantee* schemes, which provide an important safeguard of depositors' interests. Both were the subject of Commission Recommendations in December 1986.

We are at present in the process of establishing what steps have been taken in the Member States to implement those recommendations. In the light of that investigation we must decide whether it is necessary to proceed with binding legislation.

Armed with the assurance that common standards have been set in all these areas, Community Supervisors are prepared to operate the system of home-country control and mutual recognition and thus to enable the long sought-after freedoms of establishment and provision of services to be achieved.

### Liberalised banking activities

Beyond this, and this is the feature of the Second Banking Directive which is most far-reaching, those freedoms are sought for specific banking activities. The list of banking activities which will benefit from liberalisation is a long one, following a universal banking model and including mortgage credit. If a bank is authorised to engage in these activities under the

## 'Setting common standards'

terms of its home-country licence, it may offer them in other Member States, either through a branch or through cross-border provision of services.

As previously mentioned, the provision of mortgage credit also appears on the list of liberalised activities. But this will not suffice to clear the ground for a truly free market in mortgage credit. The legal systems, the financial institutions and their products which lie at the basis of house purchase have evolved differently throughout the Member States. The diversity of these

systems, in which consumer protection plays an important role, is a major barrier to real intermarket penetration and it will continue to remain so unless further measures are taken.

### *Mortgage credit directive*

It is the Commission's proposal for a Mortgage Credit Directive — currently under discussion in a Council working group — which is intended to overcome the barriers that remain after the Second Banking Directive has come into force.

The Commission has not attempted harmonisation of the existing mortgage credit systems, because those systems vary widely between

## *'Overcoming the barriers'*

Member States for historical, cultural and political reasons. Our approach in the proposed directive is based on the mutual recognition of "financial techniques", which will mean that mortgage lenders will be able to market their own, developed product in other countries, either through branches or provision of services.

As you may expect, the discussion on the definition of "financial techniques" is complex and lengthy, but we are convinced that it should be possible to offer, for instance, both British endowment mortgages, Dutch-style life insurance mortgages and German Bausparkassen loans anywhere in the Community.

The present compartmentalisation of mortgage markets in the Community is certainly detrimental to the consumer, who should have the opportunity to search for the best terms and conditions for the largest financial commitment he will probably ever enter into in his life. But in the long run it is also damaging for those credit institutions which wish to expand and make moves into other mortgage markets.

Last, I would like to mention our work on a proposal for a directive harmonising the issuing of mortgage bonds. As some of you will probably

know, we have come to the conclusion that the Second Banking Directive and the Directive on the Liberalisation of Capital Movements will already suffice to guarantee an adequate degree of liberalisation in this area. The Second Directive's list of banking activities, which I mentioned before, includes the elements of "trading for own account in securities" and "mortgage lending". These elements, taken together with the liberalisation of the accompanying capital movements, should neatly cover our objectives in the mortgage bond sector.

Work on a Mortgage Bond Directive will, therefore, not be pursued for the moment. But we do not rule out that work might be continued at a later date. This will depend on the way in which the unified market in financial services will be working; a directive on the issuing of mortgage bonds might still prove desirable if it could improve efficiency, lower prices and bring greater legal simplicity to the mortgage market.

### *Opportunities of 1992 for building societies*

1992 is now well on the way, but to a considerable extent it is up to institutions to determine what it will bring for European building societies. Many of the changes implied by Community legislation are already taking place in individual Member States.

Building societies' deposits have increasingly assumed the characteristics of bank deposits. Irish building societies are going to get sweeping new powers to move into banking, insurance and a wide range of other financial services; German mortgage banks have recently been allowed to operate outside Germany, albeit on a restricted scale. I would also like to mention the British building societies' moves into the Spanish mortgage market, and those of Danish institutions into Germany.

It is clear, however, that the nature of the changes you will all be facing will assume a European dimension,

both in the lead up to 1992 and after that date. The internal market will offer greater geographical horizons to all European building societies. At the same time, a greater degree of competition, both between building societies themselves and other institutions, is inevitable and, of course, highly desirable.

Present trends also suggest that building societies, as certain banks, may seek to acquire a European presence before 1992 by establishing links with other institutions located in other Member States. For example, Banque Nationale de Paris recently acquired Chemical Bank's UK mortgage subsidiary, and the Spanish authorities are actively encouraging mergers of their credit institutions so that they can be better placed to compete on a European-wide scale.

As a general proposition, I would also think that the real opportunities lie with specific financial products tried and tested in one or two national markets but not yet available in others. Commercial opportunities will be greatest where existing

## *'The foundations are in place'*

national practices and markets exhibit the greatest differences.

### *Conclusion*

I hope that I have helped to clarify our plans for creating a Single European Market in financial services and can safely say that the foundation and walls are in place. We have nearly completed the roof, but it will be up to you to provide the furniture to your own taste and to reap the benefits of the Internal Market to which we all aspire. ■

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