Mortgage insurance in Europe

EARLY in 1987, the two European federations decided to initiate and arrange a study into mortgage insurance, and other insurance-related aspects of mortgage lending. The study was felt to be necessary because:

(a) There are widely differing systems of mortgage insurance and each country can learn from the experience of others.

(b) As lenders increasingly operate across national frontiers, they need to be familiar with the different techniques of mortgage insurance.

(c) The question of mortgage insurance is relevant to the operation of secondary mortgage markets which, by definition, are more international than primary markets.

The terms of reference for the study covered:

(a) The insurance of mortgage loans.

(b) Policy and practice with respect to state assistance to borrowers who have difficulty in repaying their mortgage loans.

(c) The experience of countries with respect to mortgage arrears and default.

(d) Policy and practice with respect to mortgage loans linked to endowment insurance policies.

(e) Policy and practice with respect to the insurance of properties mortgaged to housing finance institutions.

The study was carried out by a group comprising executives from institutions belonging to the two federations. The convenor of the group, who acted as both chairman and secretary, was Ian Lumsden of the Halifax Building Society in the United Kingdom.

The European Federation of Building Societies and the European Community Mortgage Federation will shortly jointly publish a study, *Mortgage Related Insurance in Europe.*

This article briefly sets out the nature of the study, and then draws on the individual country chapters to describe the insurance of mortgage loans in each of the countries studied. The article concludes by reproducing the conclusions of the study.

Insurance of mortgage loans — general considerations

By insurance of mortgage loans is meant systems which protect the lender rather than the borrower from the consequences of the borrower defaulting on his loan. Some of the countries in Europe have no system for insuring mortgage loans. Among the others, there are several systems by which lenders can protect themselves against default by borrowers:

(a) By the whole loan being insured.

(b) By the amount of a loan exceeding a set percentage of the valuation of the property being insured (the system used in Britain).

(c) By borrowers being required to contribute separately to a reserve fund to cover losses (the system used by Danish mortgage credit institutes).

(d) By borrowers being required to provide guarantors (as in West Germany and France).

The manner in which any insurance is effected can also differ between countries. The Danish mortgage credit institutions effectively use the self-insurance system. In Britain, top slice mortgage insurance is undertaken by the large insurance companies as part of their normal business. In many non-European countries (the USA, Australia and Canada, for example), there are specialist mortgage insurance companies or government agencies.

There is a close relationship between mortgage insurance and lending terms:

(a) The mortgage insurers may effectively determine lending criteria, for example, loan to income and value limits.

(b) Mortgage insurance may be needed for all loans or simply for loans which fail to meet certain criteria.

West Germany

There are no mortgage insurance schemes in West Germany. This is because lenders and insurance companies fear that mortgage insurance covers unspecified risks; that means collective risks, and, therefore, the probability of loss is impossible to calculate. They may also be reluctant to introduce mortgage insurance, because this would shift the risk of loss from lender to insurance company, and this might encourage the lender to engage in riskier lending.

The Bausparkassen cannot lend more than 80% of the value of the property unless adequate additional collateral is pledged. Bank guarantees provide the additional collateral. Some Bausparkassen co-operate with institutions specialised in guarantee undertaking, and act as an intermediary for guarantees.

A guarantee fee is usually around 1% of the guaranteed top slice of the loan. After a mortgage claim has been made against the guarantor, the guarantor may have recourse to the borrower.

Belgium

Belgium also has no mortgage insurance system providing for specific and systematic insurance cover for mortgage loans. However, certain companies do have recourse to credit insurance. Mortgage credit is just one of many transactions covered by credit insurers, and it is impossible to give precise information on the amount of mortgage business which is covered. The system is not widely successful for a variety of reasons.

Credit insurance normally covers all the business handled by the lender so as to spread the risk and to reduce premium amounts. The agreement between the insurer and insured lender usually stipulates a threshold, for example 50% or 80% of the public site value, at which the lender is required to submit the case to the credit insurer. The insurer will conduct his own investigations. Although cover extends throughout the loan period, mortgagees often require cover for only the initial years of repayment.

In the absence of credit insurance, lending companies generally make the granting of loans with high lending ceilings conditional on the provision of certain additional guarantees or risk premiums, such as an increase in the interest rate, the pledging of securities or the personal guarantee of a third party.

Denmark

Mortgage lending in Denmark is highly regulated and mortgage insurance is unknown. The rules under which the institutions operate are designed to safeguard the safety and solvency of each institution.

The law lays down maximum lending limits and loan terms. There must also be equivalence between the borrowers' mortgage debts and the nominal value of mortgage bonds in circulation. There are special requirements in respect of the minimum amount of reserves.

Reserves for residential mortgage loans have to be at least 5% of the value of bonds in circulation. This is met by way of an up-front payment of 1% of the principal, and a contribution of 2% of the quarterly or semi-annual instalment. It should also be noted that borrowers have joint and several liability for the obligations of the institution.

Spain

Until recently, there was no credit insurance for mortgage loans. Institutions protected themselves by carefully assessing the property that would serve as security, and by not lending more than 70% or 80% of the assessed value of the property. However, the situation is now changing.

Strong competition in the mortgage market is causing the amounts loaned to tend to approach the real value of the property. Fluctuations in the real estate market or poor upkeep of the property may also cause problems to lenders. Credit insurance companies offer various services to the financial institutions including foreclosure of the mortgage, and they will advance the amount of the debt outstanding to the lending institution.

France

There is no mortgage insurance in France nor is credit insurance practiced in the field of mortgage credit. To cover himself, the lender may require:

(a) A mortgage security on the property which is the subject of the loan.

(b) A mortgage security on another property belonging to the borrower.

(c) The joint guarantee of one or more persons.

(d) The mortgage guarantee of one or more persons.

United Kingdom

Where building societies lend more than 80% of the value of the property, a system of mortgage insurance is used. Building societies have operated this system for many years. The main features are:

(a) Insurance cover is given by composite insurance companies rather than by specialist mortgage insurers.

(b) The top slice of the loan, that is, that part of the loan above 80% of the purchase price, is insured.

(c) A single premium is paid by the borrower at the time the loan is taken out. Currently, premium rates vary from 3.5% of the amount insured, for loans between 80% and 90% of purchase price, up to 7% for amounts over 95%.

Ian Lumsden, convenor of the Research Group on Mortgage Insurance.

40 →

← 39

(d) Building societies undertake all the additional administration and tell the insurance companies what loans have been insured.

(e) When a building society makes a claim, it notifies the insurance company of the amount which is then paid. A claim exists only where the sale proceeds of a property taken into possession are lower than the outstanding loan, plus the costs of possession.

Greece

There is no mortgage insurance system in Greece. The maximum amount of a loan is about 50% of the market value of the property and market prices have never fallen in the last 20 years. However, a large number of loans have a state guarantee. This guarantee is given to earthquake victims and can also be given to some large organisations if they build houses for their employees or for students.

Italy

Regulations governing loans secured on existing buildings require as collateral against the obligations assumed by the borrower, only the granting of a mortgage on the property to the lending institution. Regulations governing lending for housing under construction give the lender the right to request at the borrower's expense additional mortgage guarantees for that part of the loan that exceeds 50% of the cost of construction, including land purchase. There are three principle forms of supplementary guarantee used to back loans:

(a) Guarantee from a third party (normally a bank), which guarantees the payment of the loan instalments or repayment of the entire principal.

(b) A guarantee policy issued by an insurance company (in exchange for a single payment premium paid by the borrower, prior to the disbursement of the loan) for the amount in excess of 50% of the building cost.

(c) Supplementary or auxiliary state guarantee of the full repayment of principal, interest and related charges.

Portugal

In Portugal, there is no mortgage guarantee insurance system as such. However, such insurances are provided by insurance companies accepted by the mortgage lender, and with the consent of the insurance companies. In the case of loss, the mortgage lender has the contractual right to receive directly from the insurer the indemnity.

Norway

In Norway, lenders do not normally lend more than 80% of the valuation, which is generally lower than the purchase price. If the borrower wants a higher loan, then he will be required to give a bank or personal guarantee. Some credit institutions would extend the 80% limit with a customer credit insurance to cover losses caused by the borrower's insolvency.

The Netherlands

In the Netherlands, there are no legal requirements relating to mortgage related insurance. There are two types of insurance relevant to mortgage interest:

(a) Mortgage interest insurance through a mutual guarantee pledge.

(b) Top slice insurance. The lender can insure his total portfolio against all risks of not getting repayment of the mortgage for what ever reason only for the top slice of the mortgage loan, that is, above 100% of the foreclosure value.

Conclusions

The conclusions of the report are set out in full below:

"The country chapters in this study illustrate major differences between the European Community countries as to the security which mortgage lenders take, in addition to the property itself. It is clear that there is no single best practice in this respect. Each country has a unique housing finance system which has been shaped by housing policy, the structure of the financial system and the taxation system. The security which a lender looks for will vary according to a number of factors which differ between countries.

"In countries where high percentage loans are not required then, clearly, lenders can rely to a large extent on the property alone as security. In countries where the housing finance market requires high percentage loans, then lenders do need security in addition to the property itself. There are a number of types of additional security of which bank guarantees and insurance policies are the most common.

"The extent of state support for borrowers who have difficulty in meeting their repayments also differs markedly. This in itself can be seen as a form of mortgage insurance, and the more there is state support, the less the lenders themselves need to seek additional security.

"Perhaps the one conclusion that can be made is that mortgage insurance does enable higher percentage loans to be made than would otherwise be the case, and also significantly reduces the risks faced by lending institutions. In turn, high percentage loans can, depending on the relationship between property prices and incomes, allow people to become owner occupiers, either who could not do so at all, or at an earlier age than would otherwise be the case.

"The study explains the insurance aspects of mortgage lending, and enables the reasons for the differences between the countries to be clearly seen. Each country can learn from the system of others, and it is hoped that the study will enable relevant institutions to assess whether they have the most effective system of protecting lenders and borrowers in the light of their own special market conditions." ■