

NOTABLE EVENTS



VISA Event – “The Shadow Economy in Europe, 2010”

CEPS/ECRI is planning an event with VISA to discuss the report on “The Shadow Economy in Europe, 2010”. The new study explores the structure and impact of the shadow economy and evaluates the role that electronic payments can play in reducing it.

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REGULATORY AFFAIRS

A further step in harmonizing the European Mortgage Market

The Commission’s proposed Directive on Credit Agreements Relating to Residential Property has been designed to boost consumer confidence and radicalize the unorthodox lending practices that took place during the boom years across Europe, and contributed to a range of property bubbles, overindebtedness, defaults, and foreclosure cases across EU member states.

The proposed Directive aims to regulate the European mortgage credit industry through robust rules concerning advertising, pre-contractual information, advice, creditworthiness assessment, and early repayment rights. Consumer protection must be reinforced by ensuring that all consumers taking out a mortgage loan are adequately informed about the risks involved. Consumers will be able to compare mortgage conditions from different providers through the personalised ‘European Standardised Information Sheet’ (ESIS).

[Retrieve more information on page 3](#)

ECRI Industry Survey on credit reporting in Europe

Brussels, 2 March 2011 - The Association of Consumer Credit Information Suppliers (ACCIS), in collaboration with the European Credit Research Institute (ECRI), has put forward a comprehensive survey on Europe’s credit reporting markets. The report assembled data from 30 credit bureaus in 23 European countries, with the ambition to identify and understand the differences that exist in Europe’s credit reporting systems.

It was acknowledged that the ideal data collection procedure should take into account both positive and negative data on borrowers’ creditworthiness and it should extend across all types of credit, from the secured mortgage loan to the unsecured consumer credit, down to utilities such as mobile phones and energy. This is unfortunately not the case today, since the credit bureau landscape in the EU, as demonstrated by the report, is still highly fragmented and in need of incentives to encourage a wider data-sharing among and within nations.

Questions raised during the launch event of the report focused on the extent of data-sharing that takes place at present, and the benefits that would come with it, if the practice were amplified. According to the responses given by the surveyed credit bureaus, only those operating in 6 of the 23 countries are required by national law to share their data. Regulatory action was pointed out as one means of gaining more comprehensive databases, which would strengthen the financial infrastructure and facilitate the access of finance for consumers.

The importance of data-sharing between creditors is essential for establishing a well-functioning pan-European credit market. We have to bear in mind that if credit providers have easy access to accurate, complete and up-to-date data on borrowers’ creditworthiness, the decision process for granting credit would be based on a sounder foundation. It would further reduce information asymmetries, such as moral hazard and adverse selection, and responsible lending obligations would be more easily met.

However, it was recognized that cross-border reporting is still in its infancy due to a lack of demand, where the cost of restructuring is not in line with the current low demand for cross-border lending. Referring to the report of the Expert Group on Credit Histories (EGCH), the incentive to share information between creditors depends on three factors, namely, the mobility of borrowers, the heterogeneity of the population and the degree of competition in the financial sector. Further, the EGCH recommends that a single pan-European retail credit register is not the best solution for the foreseeable future a view that seems to be shared by other stakeholders as well.

Further remarks were made on the fragmented data collection procedures that are currently used by the different credit bureaus; for example, 23 out of the 30 surveyed collect and store both negative and positive data. The reason why all bureaus not have this possibility is due to varying regulatory structures that restrict their ability to store positive information.

Moreover, when it comes to the type of data that is collected, the survey confirms that roughly half of the bureaus have records with legal-types information such as bankruptcy or insolvency data, whereas only a fifth possess data on personal standing, e.g. income and other assets. Gillian Key-Vice, Member of the Executive Committee of ACCIS, shared her concerns over this lack of valuable information that is not being collected or shared for the moment, which could further strengthen credit assessment. Besides that, she raised a cautionary finger on the variety of loan data that are being registered, where the majority of the bureaus have records of mortgages, credit cards and consumer loans, but only a fraction of them keeps track of utility payments, such as mobile phone contracts, mail order and other indispensable utilities such as gas and electricity contracts.

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Since its founding in 1999, activities of the European Credit Research Institute (ECRI) have been managed and staffed by the Centre for European Policy Studies (CEPS). Unless otherwise indicated, the views expressed in this newsletter are attributable only to the contributors in a personal capacity and not to any institution with which they are associated.

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Tanguy van de Werve, Director General of Eurofinas, commented that 30% of the people in Belgium who are considered to be over-indebted are thus categorized mostly due to their inability to meet the payment of standard utilities. In fact, when people meet dire straits, the debt that tends to go into default is usually the telephone bill. This has made telecom companies eager to collaborate with each other, opening the doors for increasing data-sharing in order to minimize that risk.

Lenders may (and should) consult credit bureaus or other sources before granting credit, but this is not carried out systematically throughout the EU, since they are not legally required to do so in a majority of the member states. The report revealed that only 5 of the 23 countries have national legislation that obligates credit-granting institutions to consult a credit-reporting database. The obvious question raised was whether it should be compulsory for lenders to consult credit-reporting databases prior to the credit granting process, since this low number does not go hand in hand with the Commission's responsible lending initiatives, and surely more should be done in this area to improve credit assessment procedures.

The report also revealed another ambiguous area regarding the standards used by credit bureaus for determining when credit is considered to have gone into default, i.e. a non-performing loan. Almost all credit bureaus responded that they store information on default credit; however, the responses showed that the definition and terms that are used for classifying when credit has gone bad are totally arbitrary. The time that it takes for a credit to be registered as default ranges from less than 30 days up to 90 days. Others used different criteria such as the amount of reminders/default notices being sent or, an even vaguer definition, which depended strictly upon the client's profile.

There is no doubt that the results provided by the survey opened up a lively discussion. The quest for obtaining a more efficient and integrated European credit market continues. The current financial crisis has proven how important it is to evaluate thoroughly and responsibly borrowers' creditworthiness. However, the survey identified a fragmented market, which is in need of more incentives to increase data-sharing as well as setting up a common framework that harmonizes the day-to-day work of credit bureaus.

More advanced markets possess highly comprehensive databases, whereas in countries with recently created registers, the product line is much narrower. It seems that the goal of achieving a certain depth and breadth in the data collection of borrowers' creditworthiness is closer for some countries than other.

The report is said to be an important step for the follow-up work of ACCIS, which represents their members in discussions and negotiations with regulators. One of their main objectives is to support the most wide-ranging credit information model that enables a data collection process that is both extend broad and deep.

Download full report at: <http://www.ecri.eu/new/node/228>

EC Directive: A further step in harmonizing the European Mortgage Market

Brussels, 31 March 2011 – The Commission’s proposed Directive on Credit Agreements Relating to Residential Property has been designed to boost consumer confidence and abolish the unorthodox lending practices that took place during the boom years across Europe, which contributed to a range of property bubbles, overindebtedness, defaults, and foreclosure cases across EU member states.

The proposed Directive aims to regulate the European mortgage credit industry through robust rules concerning advertising, pre-contractual information, advice, creditworthiness assessment, and early repayment rights. Consumer protection must be reinforced by ensuring that all consumers taking out a mortgage loan are adequately informed about the risks involved. Consumers will be able to compare mortgage conditions from different providers through the personalised ‘European Standardised Information Sheet’ (ESIS).

The sustainability of the rising household debt in Europe has been questioned for some time now, and the Commission is trying to bring imprudent mortgage lending and borrowing practices back to fundamentals before more severe problems arise. The significant amount of outstanding residential mortgage lending in the EU27 represents approximately 65% of the EU’s GDP in 2009, and the need for a common EU-wide legal framework became indispensable after seeing what the US subprime crisis did to American households.

The economic downturn has uncovered severe problems in some Member States (e.g. Poland, Hungary, Latvia, Romania and Estonia) where a large proportion of mortgage loans issued were denominated in foreign currencies. This allowed temporary benefits by taking advantage of lower interest rates prevalent in other currencies such as the Swiss franc, but many were aware of the currency risks involved in such a contract. In the aftermath of the crisis, the idea of having a mortgage loan denominated in foreign currency with a maturity of e.g. 30 years does not sound appealing, considering that the currency exposure caused a number of defaults and foreclosures when people saw their local currency depreciate.

The Directive is now looking to minimize the likelihood that consumers will purchase inappropriate products due to uninformed decisions and unsuitable credit-granting procedures by lenders, which has to some extent increased the numbers of EU citizens that can no longer honour their debts. A range of studies on the costs and benefits of integrating EU mortgage markets highlights the positive impact of such a package.

However, the Directive has encountered resistance from the industry and mortgage lobbyists, which claim that their concerns have gone unheard. The proposed measures for regulating EU mortgage markets and supervising all financial institutions involved in the origination and distribution of mortgage credit are seen by certain groups as biased. The Commission’s partiality towards consumers is thought to make it harder for financial institutions to grant credit, as lenders may become too cautious when assessing borrowers’ creditworthiness, thus making it harder for first-time buyers to receive mortgage loans.

The forthcoming CEPS-ECRI Task Force Report, entitled A New Mortgage Credit Regime for Europe – Setting the Right Priorities, addresses the micro regulation of mortgage credit in the EU, and makes a series of recommendations regarding credit distribution, underwriting and contracting. Some of the recommendations are part of the Commission’s proposal, whereas more action is called for to make sure that mortgage providers and credit intermediaries act in the consumers’ best interests.

More information can be retrieved from:
http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm

VISA Event – “The Shadow Economy in Europe”



CEPS/ECRI is planning an event with VISA to discuss the report on “The Shadow Economy in Europe, 2010”. The new study explores the structure and impact of the shadow economy and evaluates the role that electronic payments can play in reducing it.

Although the exact size of the shadow economy is difficult to ascertain, it is believed to be about €2.1 trillion in Europe. In Germany and France, this sector is about one-eighth the size of the countries’ official GDP, but in less-developed Eastern European nations, such as Bulgaria, Croatia, Lithuania and Estonia, it is 30% or more.

More people are inclined to work outside the normal, legal framework as the global economy continues to struggle. Therefore, it’s important to understand the positive and negative effects of the shadow economy, so countries can take the right steps toward capturing lost revenues, protecting workers and providing for their citizens.

Within this context, A.T. Kearney and Friedrich Schneider, Ph.D., Professor of economics and Chair of the Department of Economics at Johannes Kepler University in Linz, Austria, conducted a study to explore the structure of the shadow economy in Europe and identify measures to reduce it. Dr. Schneider divided the shadow economy into 12 industry sectors in six European countries. Analysts at A.T. Kearney scrutinized the data and evaluated the range of solutions used in countries around the world. The firm also explored which industry subsectors could benefit most from the use of electronic payment systems to reduce the size and impact of the shadow economy.

Meeting Announcement & Agenda will be posted on ECRI’s Homepage in due time.

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Download the full report at: <http://www.visaeurope.com/idoc.ashx?docid=2758850c-b05e-4d61-bffd37226316e72c&version=-1>

Consumer credit demand is on the rise

The outbreak of the sovereign debt crisis in the eurozone has made it difficult for some banks in the EU ‘periphery’ countries to access the wholesale markets for funding. The outlook, however, is more stable for the large and more diversified banks, according to Fitch’s Southern Europe prognosis. Nevertheless, the Greek and Portuguese banking sectors are still facing funding and liquidity difficulties due to gloomy macroeconomic conditions. So do some of Spain’s savings banks or ‘cajas’, which were severely hit by the Spanish property bust. The current state of credit markets and banks’ lending ability is still characterized by tensions and uncertainty, but many have started to see the light at the end of the tunnel.

Besides covering lending activity, the survey highlighted that the amount of debt restructuring has continued rising for the period 2010 Q4, due to an increase of troubled borrowers who have sought renegotiation on their debt. According to the report, “the ratio of restructured mortgage loans to mortgage loans outstanding rose from around 7% to 9%” and “restructured mortgage loans more than 30 days delinquent as a proportion of restructured mortgage loans outstanding also increased moderately, from 27.5 % to nearly 30%”. Banks believe that debt restructuring is expected to continue rising in 2011, and the ratio of restructured mortgage loans to mortgage loans outstanding may well reach 10% by the end of the year.

Figure 1. Willingness of banks to extend housing loans and consumer loans



Source: Magyar Nemzeti Bank, Senior loan officer survey on bank lending practices, February 2011.

The Magyar Nemzeti bank published the results from its survey on bank lending practices. The surveyed banks perceived an overall rise in the demand for housing loans and consumer loans by a net 35% and 29%, respectively in 2010 Q4 (Figure 2). The types of consumer loans driving the increased demand have largely been credit card and hire purchase loans. Vehicle financing has been dragging down the aggregated demand on consumer loans.

The overall outlook for 2011 indicates that further a rise in credit volume is likely to take place, with the exception of outstanding household loans that are likely to fall further due to the large amount of maturing loans in the period. The report affirms that “growth in lending is expected to be fuelled by the expansion of sales channels, in addition to a pick-up in demand, rather than by a material easing in credit conditions”.

Download full report at: http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Penzugyi_stabilitas/hitelezesi_felmeres/mnben-hitelezesi-felmeres-201102/SLO_2011.01_ENG_final.pdf

However, banks state that credit conditions on housing loans have been tightened due to strategic and profitability reasons, rather than macroeconomic changes. Similar patterns have been observed in the US, where credit conditions on mortgage lending continues to be restrictive, whereas consumer loans seem to have picked up.

Figure 2. Demand for housing and consumer loans



Source: Magyar Nemzeti Bank, Senior loan officer survey on bank lending practices, February 2011.

Integrating Retail Financial Markets in Europe

CEPS Senior Fellow, Rym Ayadi, argues in her latest publication that European policy-makers ought to rethink their approach to financial market integration in order to continue the construction of the internal market for retail financial services. Although the liberalisation of capital movements and the elimination of currency barriers have helped bring markets together, partly achieving a single market for the wholesale segment, market integration for retail financial services remains elusive.

The new – post-crisis – Financial Services Action Plan (FSAP) must consider appropriate lessons from the crisis and be aligned with the new philosophy of the 2020 European agenda for sustainable and inclusive growth. Urgent efforts should be taken to ensure financial safety for retail consumers and to enhance consumer protection at the EU level. In order to establish an integrated and competitive European retail financial service market, other noteworthy prerequisites include: efficiency, stability and inclusion, all of which are still lacking.

In order to restore market and consumer confidence in retail financial services, Dr Ayadi calls for the implementation of European frameworks for financial safety, regulation and consumer protection. The existing fragmented deposit insurance framework cannot safeguard nor restore the confidence of individual depositors. The single market in financial services requires a European solution to this problem. Existing directives in the retail financial market area are outdated and must be renewed in order to achieve the regulatory coherence and convergence necessary for retail market integration.

Regulation needs to be complemented by a credible system of sanctions if rules are breached. Information on retail financial products must be easily available, and disclosed in a consistent, comparable and understandable way to allow consumers and investors to make appropriate choices and decisions. Suppliers of retail financial services need to develop tested and effective practices for thoroughly assessing consumers' needs and level of financial sophistication, so that suitable advice and recommendations are given.

Furthermore, the Commission should produce clear guidelines on: i) consumer needs assessments (for example, information gathering, transparency level and adequacy of financial services) and ii) recognised professional standards to ensure that intermediaries/advisers apply consistently high standards in their domestic and cross-border services. The interests of end-users of financial services (consumers, pensioners, small enterprises, retail investors, etc.) must be better represented at the EU level.

Download full report at: <http://www.ceps.eu/book/integrating-retail-financial-markets-europe-between-uncertainties-and-challenges>

REGULATORY AFFAIRS

Responses from consultation on access to a basic payment account

The responses from the Commission's public consultation on access to a basic payment account were released on 25 January 2011. This initiative is among several broad actions taken by the Commission in the area of financial inclusion. The study on the costs and benefits of policy actions in the field of ensuring access to a basic bank account revealed that about 30 million citizens in the EU (above the age of 18) still do not have access to a bank account, of whom 18 million are likely to be at risk of financial exclusion. Stakeholders had the possibility to comment on the principles of a harmonizing framework set up to ensure that no one is denied access to a basic bank account.

All stakeholders acknowledged that having access to payment services is necessary to allow consumers to fully participate in and benefit from the internal market. However, different views were expressed on whether a harmonized framework would be the best solution. Public authorities and industry representatives believe that action at the EU level would neither be justified nor proportionate, since national divergences are present. Action at national level combined with EU recommendations would be more suited for combating financial exclusion, giving that each member state still has its own level of economic development.

The opinion of some public authorities on the characteristics of the basic payment account was that they should be limited at a first stage, offering mainly cash withdrawal. Additional services and functionalities could be offered for those who successfully manage the account over a given period of time. However it was admitted that it would be difficult to define a harmonized set of payment services at EU level since consumers' needs may vary across member states.

In contrast, the consultation revealed that consumer/user and representatives/advocates supported the framework to a higher degree, thus calling for a broader range of services that should be provided by appropriately trained bank staff. Further, it was pointed out that a resident permit or a valid address should be sufficient to open a basic payment account.

The majority of the stakeholders agreed with the envisaged measures related to general information concerning basic payment accounts. It was pointed out that the information provided to consumers should be clear, concise and understandable.

Download the study and summary at: http://ec.europa.eu/internal_market/finservices-retail/inclusion_en.htm

Options for reforming deposit protection schemes in the EU

ECRI's latest policy brief builds upon the discussions at the seminar on "Skating on thin ice: What deposit insurance scheme for Europe?" held at CEPS on 12 January 2011. The policy brief reviews the current debate on deposit insurance in the EU, acknowledging that the existing deposit insurance arrangements in Europe need to be changed, as they match neither market integration nor consumer expectations.

The wide variety of deposit guarantee schemes has not proven to be crisis-resilient. The authors believe that the Commission's proposal does not represent a sufficient response to the problems raised by the crisis. Aspects related to the governance of DGS, their role in financial stability and the cross-border dimension have not been sufficiently addressed, leaving scope for regulatory arbitrage, competitive distortions and moral hazard. Further harmonisation is desirable to sustain an integrated financial market.

Download full report at: <http://www.ceps.eu/book/options-reforming-deposit-protection-schemes-eu>

FORTHCOMING PUBLICATION

Mortgage default torrent – The possible spillover effect from the eurozone debt crisis

The forthcoming ECRI Commentary takes a closer look at the mortgage situation of households in Portugal, Italy, Ireland, Greece and Spain – countries whose economic condition have been under the magnifying glass throughout the ongoing eurozone debt crisis.

The credit markets in these countries have witnessed a fast-paced development, where credit extended to households has increased considerably during the last decades. What will be the outcome for average citizens when they start to feel their belt being tightened by their government's insolvency or/and liquidity problems? A mortgage default torrent may be lurking behind the euro debt crisis, if appropriate measures are not taken to cure both the sovereign debt crisis and protect borrowers' ability to repay back their loans.

Further information: angelo.fiorante@ceps.eu

RECENT DEVELOPMENTS

The US foreclosure crisis rumbles forward



On 20 May 2009, US President Obama signed the Helping Families Save Their Homes Act, which was an important step towards stabilizing and reforming the nation's financial and housing markets that were severely struck by the crisis. It helped American homeowners to increase their flow of credit during the difficult economic times. Loan modification possibilities were offered along with Home Price Decline Protection (HPDP) Incentives and the Foreclosure Alternatives Programs.

Today, the Obama administration is planning to go much further than the mortgage modification efforts of 2009, proposing that the debt outstanding of thousands of US mortgages should be written down to compensate for the improper and mechanical

foreclosure procedures initiated by large US banks. The writedown of principal would have a positive effect on the stagnating US housing market as it would boost consumer confidence.

However, government interference has always met with criticism in the US, and the idea of forcing banks to write down the principal on mortgages could backfire on the sitting government. Skepticism is growing since it is still unclear who will be eligible to receive a 'bail-out' and who will provide the funding, for that matter. Tom Miller – who is leading a nationwide investigation of improper foreclosure practices – told the Financial Times that his team is still working on who would fit the criteria, but guarantees that only the most distressed borrowers would be entitled to a principal writedown. Regulators and officials are proposing that only those directly harmed by wrongful foreclosures should receive restitution, and that the aggregated size of \$20 billion of fines being discussed may offset banks' lending capacity.

After the American housing bubble burst, homeowners found themselves in foreclosure for a number of reasons. The mortgage payment ability of borrowers has taken a beaten from the double-digit unemployment rate, while others purchased properties they could never really afford. However, an additional driver of home

foreclosures has become clearer as the crisis rumbles forward, namely the increasing number of 'strategic mortgage defaults' that are taking place in the US. The Financial Times (March 24, 2011) reports that "almost 4 out of 10 homes today are sold by someone who either cannot pay their mortgage or will not because he or she owes more than the home is worth".

Analysts recognize that the industry is facing two main problems: the burden of approximately 4 million foreclosed homes that is pushing down property prices, and a credit crunch that is holding back new mortgage lending. Banks have tightened their lending standards by requiring higher credit scores and larger downpayments from borrowers.

In the meantime, US banks have been told in a meeting led by the Federal Deposit Insurance Corporation (FDIC) to consider paying delinquent borrowers up to \$21,000 each as an incentive to leave their homes. The 'cash for keys' foreclosure strategy has been already applied by some banks, which find it a cheaper and quicker means of evicting delinquent borrowers than setting up a court order.

Additional information: <http://www.whitehouse.gov/blog/Protecting-Homeowners-Protecting-the-Economy/>; <http://www.ft.com>

ECRI STAFF UPDATE



After three and a half years at ECRI within CEPS, **Marc Rothmund** has joined JP Morgan in London, where he works in the bank's government relations department. While at ECRI Marc specialised in the areas of consumer loans, credit reporting and retail financial services issues, and he produced the annual ECRI Statistical Package.



At the end of 2010, **Maria Gerhardt** left her position at ECRI to pursue a PhD in Economics at the University of Ghent. At ECRI, her main research areas included retail banking markets, credit reporting, consumer insolvency regimes and deposit insurance schemes. In Ghent, she is working in the Department for Financial Economics, carrying out research on financial stability, banking market structures and sovereign debt exposure.



Elina Pyykkö will be joining CEPS as of May 2011 as a Researcher at the European Credit Research Institute. She holds a Ph.D. in Financial Accounting and a M.Sc. in Financial Accounting, both granted by the Oulu Business School in Finland. Before joining ECRI she worked as an Assistant Professor at the Department of Accounting at the Oulu Business School, where she was responsible for several research projects in the field of equity and credit markets,

in cooperation with both corporate and credit agency representatives. She has published in the field of financial analysis in international financial economics journals as well as contributed to the general economic discussion in the form of commentaries and working papers on financial market conditions. In addition to the analysis of the price relevance of financial information, other areas of her interests include credit analysis and reporting, corporate governance and European financial regulation and integration.



Angelo Fiorante joined CEPS in February 2011 and is a Research Assistant at the European Credit Research Institute. He holds a M.Sc. in Finance and a B.Sc. in Business Administration & Economics, both granted by the Stockholm University School of Business. Before joining ECRI he worked as Research Assistant at the Finance Department of Stockholm University. He was responsible for several research projects, one of them concerning economic integration and

stock market co-movements, which was funded by Nasdaq OMX Corporation. Other areas of interests are financial development in emerging countries, banking systems and behavioral finance. Angelo is in charge of ECRI's flagship publication, the Statistical Package on consumer credit and lending to households.

We would like to wish Marc and Maria all the best as well as take the opportunity to welcome Angelo and Elina to CEPS/ECRI and wish them a pleasant start in their new jobs.