

"THE EXPRESSION OF THE ANNUAL PERCENTAGE RATE OF CHARGE
IN THE FIELD OF MORTGAGE CREDIT"

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It was carried out under the sole responsibility of Mr. Bernard VORMS.

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ANNUAL PERCENTAGE RATE OF CHARGE IN THE FIELD OF PROPERTY CREDIT

INTRODUCTION: THE STUDY PROTOCOL

The directive of 22 February 1990 amending directive 87/102/EEC on the approximation of the laws, regulations and administrative provisions of the Member States in the field of consumer credit, laid the bases for transparency of lending conditions in the various Community Member States, in particular by defining a single method for the calculation of the annual percentage rate of charge.

The directive provides for a period of six years for the practices in the various countries to be brought into line, as far as the mathematical calculation method is concerned, with its requirements.

A date has therefore been set for June 1995 to take a final decision on the choice of method to be imposed on all the countries of Europe.

The importance of housing in household commitments leads to the Commission adopting an identical approach for mortgage credit, but the questions raised are both different and more complex.

The ANIL/Agence Nationale Française pour l'information sur le Logement has already examined this question when considering the interest for consumers of cross-frontier loans; the object of this study is to provide the Commission of the European Communities with clarification on a possible directive on the displaying of rates and the development of an APRC / annual percentage rate of charge in the field of mortgage credit.

This APRC must allow the consumer to compare the real cost of the various mortgage loans available on the market.

It is a matter of ensuring fair conditions of competition between suppliers of credit and enabling the consumer to make up his mind with full knowledge of the facts.

On the other hand, the objective is in no way to seek harmonisation of the practice of mortgage credit of the various Community Member States.

The method adopted must allow effective comparison, particularly at the point in time when competition is keenest between lenders, i.e. a long way upstream of the signature of the loan contract.

It must possess several qualities:

- be logical and easy to apply,
- allow comparison of all types of mortgage credit existing in the Community,
- possess a scope with no ambiguity and be applicable to the forms of housing credit other than strictly mortgage credit.
- be as consistent as possible with the method adopted for consumer credit.

PART ONE: CONSUMER CREDIT AND MORTGAGE CREDIT

I. THE COMMUNITY PATRIMONY

1. Cross-frontier services: the law applicable

In the case of cross-frontier operations, the principle of autonomy of will prevails.

The second banking coordination directive adopts the principle of the single licence based on the mutual recognition of the rules for control of access to and pursuit of banking activities.

Nevertheless, since the borrower may be considered as passive, which is generally the case in the field of loans to private individuals, the consumer protection provisions of the host country must be respected.

There may be uncertainty about the application of this principle by the Court of Justice of the European Communities.

Indeed, the rule of the primacy of the consumer protection provisions of the host country is assessed in the light of three criteria:

- the general good,
- subsidiarity, i.e. the lack of equivalent regulations in the home country,
- proportionality: the effect of the protection regulation must not be disproportionate to the objective sought; it is the application of this final criterion which leaves room for interpretation.

2. The consumer credit directive

There is what can be termed as a Community patrimony in the credit field.

The plan to introduce an APRC / annual percentage rate of charge in the field of mortgage credit follows on from the directive of 22 February 1990 which defines an APRC in the field of consumer credit.

A concern for consistency leads to drawing lessons from the preparatory work and implementation of this first directive on the APRC..

This directive advocates the use of a single method which:

- is equivalent, on an annual basis, to the present value of all commitments agreed by the creditor and the borrower at the start of the contract, the so-called equivalent method;
- incorporates in the calculation all the sums to be paid by the two parties.

Article 2 provides that Member States must take the measures necessary to comply with this directive no later than 1 December 1993.

However, article 1a - paragraph 5 - provides that "as a transitional measure, Member States which, prior to 1 March 1990, applied legal provisions whereby a different mathematical formula could be used for calculating the APRC, may continue applying that formula within their territory for a period of three years starting from 1 January 1993."

"Six months before the expiry of the time limit, the Commission shall submit to the Council a report, accompanied by a proposal, which will make it possible in the light of experience to apply a single Community mathematical formula for calculating the APRC."

In some Member States, national legislation existing on 1 March 1990 already required the indication of an APRC.

This was the case in Denmark, Germany, Spain, France, Ireland, the Netherlands and the United Kingdom.

On the other hand, Belgium, Italy and Portugal were not subject to this requirement.

The directive has now been translated into the national legislation of the various countries:

- With regard to the elements of the total cost of the credit:

in Denmark, Germany, France, Ireland, the Netherlands and Belgium (June 1991); Portugal is preparing to do so.

Spain, the United Kingdom, Italy and Portugal are left which do not seem to have adopted any measures yet along these lines.

- With regard to the calculation of the APRC by the so-called "equivalent" method?

Not all the countries have yet adopted the equivalent method, but only France and Germany remain hostile to it; France prefers the proportional method and Germany that of 360 days.

II. THE SPECIFIC NATURE OF MORTGAGE CREDIT

1. The stakes
2. The lenders
3. Conceptual unity and diversity in practice
4. Mortgage credit and property credit not secured by mortgage

1. The stakes

In 1990, the outstandings from loans intended to finance housing alone totalled over a thousand billion ECU.

Over 50% of the credit granted to households by banks is associated with the financing of housing.

New loans granted each year account for some 15% of GNP. 70% of production is accounted for by the institutions belonging to the European Community Mortgage Federation. These figures, which come from this Federation, give an idea of the stakes.

It is true that the cross-frontier supply is still very limited: all the more reason to define the rules for fair competition respecting the interests of consumers.

In addition, property purchases made by private individuals in a Member State other than their own are increasing and provide an opportunity for international competition in loans.

The lending institutions are obviously not calling for a directive themselves as they see it as an additional constraint which may change their practices.

Some seem particularly worried about related measures which their own governments may introduce when their national legislation is brought in line with the Community provisions.

For all that, it is difficult for them to deny the legitimacy of the Commission's concern in this field, since it is merely a matter of developing a unit of measurement common to all the Member States.

It is an imperative for the information and protection of the consumer: the policies conducted to encourage accession to ownership in certain Community Member States mean that mortgage credit is no longer the prerogative only of the wealthy. The rise of the phenomena of over-indebtedness observed in recent years illustrates this point.

In addition, transparency of the information is essential to the development of fair competition between the lending institutions of the various member countries.

The rules ensuring this protection of the consumer still have to be defined, taking account of the specific nature of the practices of each country.

2. The lenders

There are a large number of different actors offering mortgage credit.

There are firstly the various categories of lending institutions; most of them are grouped together within five federations:

- the European Community Mortgage Federation
- the EC Savings Banks Association
- the European Federation of Buildings Societies
- the European Banking Federation
- the European Federation of Cooperative Banks.

Insurance companies and private individuals may also grant mortgage loans.

The author of this report has endeavoured to consult these organisations, from which he has obtained effective assistance.

A first conclusion results from these talks.

The method of presenting rates must be imposed on all and be independent of the nature of the lenders.

This is not yet the case everywhere today: for example, in Spain, the insurance companies, when granting loans, are not subject to the same requirements as the banks.

The volume of mortgage loans between private individuals is negligible: the APRC regulation could nevertheless be imposed on them since a professional intermediary (notary ...) participates in drawing up a formal deed.

3. Conceptual unity and diversity in practice

There are various mortgage credit techniques.

They are mainly linked to the method of refinancing used, but also vary according to the national legislation and tax arrangements and the traditional practice of local lenders.

Nevertheless, a great conceptual unity essentially prevails.

Mortgage credit is characterised by the special quality of its in rem security. It is a loan for which the repayment of the capital and interest is secured by a mortgage registration on a property.

Member States have intervened in various ways to guarantee the security of the mortgage loan.

In particular, the State in most countries has organised the system of land registration, the authentication of mortgages by the notaries, the recording of the mortgage in the mortgage register (land register) and the procedure of foreclosure in the event of default in payment by the debtor.

In some countries, there are provisions specific to mortgage loans, as is the case in Belgium, Denmark, Germany, Greece, Italy and Portugal.

In others, they derive from the arrangements governing the mortgage, as in the Netherlands, Spain, Ireland, the United Kingdom and Luxembourg.

The European Community Mortgage Federation has conducted some very interesting comparative studies into the regulation and practice of mortgage credit in Europe. There is no need to quote from them here, except where they refer to facts which may enter into account for the calculation of the APRC.

This is the case regarding the possible and obligatory intervention of a notary or any other professional person responsible for authenticating the loan contract and the registration in the land register.

In general, the mortgage must be created by notarial act for it to be registered in the mortgage registry, except in the case of Denmark, Ireland and the United Kingdom.

The notary is responsible for putting the act into proper form in accordance with the instructions given him by the parties and pursuant to the obligations attached to his office:

- he checks the regularity of the title to the property;
- he checks that the property is free of all mortgages or charges which would prevent the creation of the mortgage at the required rank;

- he informs the tax authorities of the creation of the mortgage.

In the Common Law countries, a role of the same kind is carried out by the conveyancer or the solicitor; in fact the latter conducts research concerning charges which could affect the property, he checks the legal transfer of title and deals with the registration of the mortgage.

4. Mortgage credit and property credit not secured by mortgage

The concern to make the APRC a real instrument of choice for consumers requires that its application is not confined to mortgage credit in the strict sense of the term, but is also extended to all credit intended for the acquisition, construction or conversion of a property.

This is the case in particular of "personal" loans for housing, i.e. loans granted to a person to finance housing, without the lender having a particular guarantee on the property financed or on another property. These loans may sometimes be guaranteed or granted by an insurance company according to its own logic: they may be in direct competition with mortgage loans and the rule of displaying rates could not be different.

The imperative is the same for the so-called top-up loans or second ranking loans and for bridging loans: here too, the rule must be the same.

It is even a constraint to calculate the effective rate resulting from the combination of several loans and which may constitute a factor in the choice.

The British define three types of property loans depending on the quality of the guarantee:

- a "mortgage" in the strict sense of the term,

- "secured", it is the fraction of the property finance guaranteed by an insurance,
- "personal" in the final category.

Likewise, the Germans have two types of security, the traditional mortgage and the land charge "Grundschuld" (cf. below), as well as housing loans without mortgage.

The rule defined by the directive for the APRC must therefore apply to any loan granted to a natural person and intended to finance a property, whether or not this loan is secured by a mortgage.

In the rest of this study, references to mortgage loans refer to loans intended to finance property in the broad sense of the term.

5. Mortgage credit not intended to finance property

Loans may be granted to finance operations not bearing any relation to housing or real estate, but secured by mortgage.

Their existence is an additional incentive in favour of the choice of a single method which is as close as possible for all credit to private individuals.

PART TWO: THE CALCULATION OF THE ANNUAL PERCENTAGE RATE OF CHARGE

I. APRC AND MORTGAGE CREDIT

1. Specific difficulties
2. The de facto conditions, the national requirements

With regard to the definition of an APRC, two types of question must be considered:

A. The mathematical terms for defining the rate: it is important, as in the case of consumer credit, to arbitrate between the various methods used in the countries of the Community.

B. The charging: it is necessary to determine precisely the costs which should be included in the APRC. This is the most delicate question.

The situation is extremely varied, as shown in the table drawn up by the European Community Mortgage Federation.

In the mortgage sector, there are several complicating factors: the duration of the loan, the large number of ancillary costs, the specific characteristics of certain types of loans.

- The duration of the loan:

Since in general long loans are involved, their conditions may undergo modification during the contract.

. Changes to the rate:

They may be provided for expressly in the loan contract. This is the case for all loans other than those at fixed term, whether their rate is variable, revisable, referenced or renegotiable.

. Changes depending on the decision of one of the parties:
the possibility, and where appropriate, the cost for the borrower of early repayment are one of the main factors for assessing the qualities of a loan.

. Changes depending on one of the parties not meeting their obligations:
the penalties which the lender is entitled to demand from the defaulting borrower are sometimes regulated, sometimes contractual.

Other factors are sometimes mentioned, which obviously cannot be included in the rate but which have a considerable influence on the real cost of the credit for the borrower:

- the inflation rate which determines the so-called "real" rate,
- the change in monetary parities, assuming the credit is denominated in a "foreign" currency.

The variety of ancillary costs:

These ancillary costs are many and varied and the ancillary services to the loan contract, of which they are sometimes the counterpart, are extremely variable depending on the loans.

The specific characteristics of certain types of loans:

Certain loans have special characteristics which must be taken into account:

- The different types of loans contain elements of variability (cf. below),
- the "composite loans which associate several products:
 - . deferred credit which meets the concern to link the loan to a period of saving;
 - . the various forms of endowment in the United Kingdom, such as the "in fine loans" defined to draw the greatest benefit from tax incentives and which comprise a loan in the strict sense of the term and an insurance product.

- The loans with a form corresponding to local particularities with regard to the method of refinancing or taxation:

- . the "Damnum" or "Disagio" in Germany;
- . the Danish system of mortgage bonds;
- . the mortgage credit lines.

Each of these special schemes must be looked at from the two points of view of the mathematical terms of the calculation of the rate and the charges.

2. The de facto conditions, the national requirements

The directive will not enter virgin territory; the legislation of some countries already provides for the obligation to indicate an APRC in the field of mortgage credit.

This is the case in Denmark, Germany, Spain, France and the United Kingdom.

On the other hand, this obligation does not exist in Belgium, Ireland, the Netherlands, Italy or Portugal.

The Belgian law of 4 August 1992 requires the lender to mention the period rate in the loan contract, but does not specify the way in which the period rate should be converted into an annual rate.

Nevertheless, even for the countries "with an obligatory APRC", the methods set out in the respective national legislation differ both in terms of the method of calculation and in the definition of the charges.

II. THE MATHEMATICAL TERMS OF THE CALCULATION

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The choice of a mathematical method for calculating the rates is no different for mortgage credit than for consumer credit.

On the contrary, it is logical for a single method of calculation to prevail, at least for loans to private individuals.

1. The advantages of the equivalent method

The existing provisions in the various countries have been perfectly analysed by Professor KIRSCHEN, during the preparatory work for drawing up the directive on consumer credit.

The Commission chose the actuarial method known as the "equivalent method", which seemed to it to be the simplest, the most logical and the most unquestionable.

Nevertheless, it is clearly felt that some credit institutions, especially in France and Germany, still feel strong reservations about the equivalent system of calculation; how can they be explained?

- The widespread use of electronic pocket calculators has led to the disappearance of the argument in favour of proportional rates which were based on ease of calculation.

In addition, the methods differ essentially in their way of converting from the period rate (monthly, quarterly or six-monthly) to the annual rate; there are few consumers who are interested in the period rate of their loan.

- Converting from the present rule (360 days in Germany and proportional rate in France) to that of the equivalent rate will mean an apparent, not real increase in the lending rate.

This increase is of about one per cent to a proportional rate of 14%: a proportional rate of 14.06% corresponds to an equivalent rate of 15%.

The monetary authorities and certain bankers are worried that this illusion of a rise may have a dampening effect on business.

- But above all, the proportional method hides the divergences between rates, whereas the equivalent method makes them more apparent: a difference of 2% in an 11% proportional rate becomes a difference of 2.23% in an equivalent rate.

Competition in terms of rates is as a result stepped up. This is the reason why the institutions whose loans are backed by the most expensive resources, are particularly hostile to the equivalent formula: they prefer to shift competition to stakes other than the rate, such as, for example, the quality of the service or the greater or lesser knowledge of the property market.

Nevertheless, none of these arguments is likely to call into question the choice made by the Commission of the so-called "equivalent" method of calculation, especially not to lead to a method of calculation specific to mortgage credit.

It may be considered that the calculation method adopted for consumer credit, but which, theoretically, could be called into question in 1996, now forms part of the Community patrimony.

According to the European Community Mortgage Federation, apart from France and Germany, which are the most hostile to the equivalent method, Ireland, Italy and Portugal would also appear to have a certain preference for the proportional method.

Nevertheless, two different methods for two types of credit for private individuals is not conceivable. This is all the more so as certain operations combine mortgage credit and consumer credit.

It would be forestalling the problems of frontiers between types of credit.

In addition, according to the same survey by the ECMF, Belgium, Denmark, Spain, the Netherlands and the United Kingdom would prefer the equivalent method.

As in the field of consumer credit, the annual percentage rate of charge must therefore be defined as that equivalent, on an annual basis, to the present value of all commitments (loans, repayments and charges), future or existing, agreed by the creditor and the borrower and calculated in accordance with the following mathematical formula:

See page enclosed (in French)

Excerpt from the Council Directive of 22 February 1990: "Basic equation expressing the equivalence of loans on the one hand and repayments and charges on the other".

Selon la réputation hypothécaire auprès de la Communauté, outre la France et l'Allemagne qui sont les plus hostiles à la méthode équivalente, l'Irlande, l'Italie et et le Portugal afficheraient également une certaine préférence pour la méthode proportionnelle.

Cependant, on ne peut concevoir deux méthodes différentes pour deux types de crédit aux particuliers. C'est d'autant plus vrai que certaines opérations associent crédit hypothécaire et crédit à la consommation.

Ce serait aller au devant de problèmes de frontières entre types de crédit.

De surcroît, selon la même enquête de la FNH, la Belgique, le Danemark, l'Espagne, les Pays-Bas et la Grande Bretagne préféreraient la méthode équivalente.

Comme en matière de crédit à la consommation, le taux annuel effectif global doit donc être défini comme celui qui rend égales, sur une base annuelle, les valeurs actuelles de l'ensemble des engagements (prêts, remboursements et charges) existants ou futurs, pris par le prêteur et par le consommateur et calculé selon la formule mathématique suivante.

EQUATION DE BASE TRADUISANT L'EQUIVALENCE DES PRETS, D'UNE PART, ET DES REMBOURSEMENTS ET CHARGES, D'AUTRE PART

(Journal Officiel des Communautés Européennes : 10 mars 1990)

$$\sum_{K=1}^{K=m} \frac{A_K}{(1+i)^{t_K}} = \sum_{K'=1}^{K'=m'} \frac{A'_{K'}}{(1+i)^{t'_{K'}}$$

Signification des lettres et symboles :

- K est le numéro d'ordre d'un prêt.
- K' est le numéro d'ordre d'un remboursement ou d'un paiement de charges.
- A_K est le montant du prêt n° K.
- A'_{K'} est le montant du remboursement ou du paiement de charges n° K'.
- \sum est le signe indiquant une sommation.
- m est le numéro d'ordre du dernier prêt.
- m' est le numéro d'ordre du dernier remboursement ou du dernier paiement de charges.
- t_K est l'intervalle, exprimé en années et fractions d'années, entre la date du prêt n° 1 et celles des prêts ultérieurs n° 2 à m.
- t'_{K'} est l'intervalle, exprimé en années et fractions d'années, entre la date du prêt n° 1 et celles des remboursements ou paiements de charges n° 1 à m'.
- i est le taux effectif global qui peut être calculé (soit par l'itération, soit par approximations successives, soit par un programme d'ordinateurs) lorsque les autres termes de l'équation sont connus, par le contrat ou autrement.

Remarques :

- a) Les sommes versées de part et d'autre à différents moments ne sont pas nécessairement égales et ne sont pas nécessairement versées à des intervalles égaux.
- b) La date initiale est celle du premier prêt.
- c) L'écart entre les dates utilisées pour le calcul est exprimé en années ou fractions d'années.

Extrait de la Directive du Conseil du 22 février 1990 : "Equation de base traduisant l'équivalence des prêts, d'une part, des remboursements et charges, d'autre part".

The presentation resulting from the use of spreadsheet software is more explicit

Payment schedule for a given amount of capital borrowed

Rank of the period	Payment	Present value
1	A	$A / (1 + i)$
2	B	$B / (1 + i)^2$
3	C	$C / (1 + i)^3$

N	X	$X / (1 + i)^N$

The period rate i is that resulting from the equivalence between the borrowed capital and the sum of the present values.

The rate is therefore an easy calculation whatever the periodicity and amount of the payments.

To convert from the period rate i to the annual rate, the following formula is used

Annual rate : T

Period rate : i

Number of periods in the year : n

$$T = (1 + i)^n$$

Nevertheless, the way in which this rule will apply must be specified, in view of certain particularities in loans granted to finance property.

2. The case of variable rate loans

A first distinction must be made between fixed-rate and variable-rate loans.

In most of the countries, fixed-rate and variable-rate loans co-exist. The mechanisms are closely linked to the methods of refinancing, but taxation too is not without an impact on the terms of the loans offered to private individuals.

Fixed-rate loans may be at a single rate or successive rates.

Variable-rate loans may be classified under various categories, of which it is worth recalling the characteristics.

2.1 Loans at revisable rates

This system, which is to be found in the Anglo-Saxon countries and Portugal, associates the variations in the cost of credit with the variations in the cost of the resources of the lending institution.

The variations in rate therefore depend on the unilateral will of the lender, who is obviously subject to competition.

2.2 Reference rate loans

This system, practised in the Roman law countries, makes the interest rate of the loan vary in accordance with a reference known by the borrower and defined in the loan contract. The reference is obviously not without a link with the cost of the resources, but it is independent of the lending institution.

In France, the reference index is contractual, defined by the institution, whereas in Spain and Belgium, it is fixed by law.

2.3 Renegotiable rate loans

Under this system, frequently used in Germany and Belgium, the rate is the subject of renegotiation between the lender and the borrower at periods provided for in the contract, according to two forms:

- either the loan is concluded for a period of "x" years with a starting rate known to the customer, but renegotiable at the end of the periods specified in the contract;

- or the loan is also concluded over a long period, but with a clause to state that it may be called in every five years by the lender (cf. "Variability of interest rates on mortgage loans in the EC" ECMF).

The renegotiable rate loans are often considered as being fixed-rate, since they appear as a series of fixed-rate loans; they must be considered as being variable rate from the point of view of the APRC, since the rate for the phases of loans other than the initial phase is not known.

On the other hand, they will be considered as being "fixed rate" when studying the question of early repayment.

It should be noted that a differentiation must be drawn between the variations in instalments and the variations in rates, which does not always exist in the public mind.

The instalments may be constant or progressive with fixed rates.

In the case of variable rates, the instalments may also a priori be constant or progressive; in addition, the variations in rates may have the effect of bringing about variations in the period of redemption of the loan and/or the amount of the instalments.

The indices adopted are linked to the cost of resources backing the loans, but the rates of redemption sometimes take account of factors deriving from the general economic conditions.

In certain cases, safety clauses (floor and ceiling on variation in the monthly instalment, limit on the prolongation of the duration) limit the consequences for the borrower of excessive variations in the indices.

Certain contracts also make provision for the possibility for the borrower to convert from a reference rate depending on indices associated with the cost of short-term resources, to a fixed rate, in turn referring to an index associated with the cost of long-term resources.

There is no reason, in the name of consumer protection, for giving preference to one type of loan against another. The fixed-rate loan presents neither more nor less risk than the variable-rate: the risk comes from the rate of inflation just as much as from the movement in the rates.

The comparative examples of France and the United Kingdom provide a perfect illustration of this point: the British borrowers, at a variable rate, felt the full force of the rise in rates, seeing their monthly instalments rise to unbearable proportions; the French, borrowing at fixed rates, lost out with the sudden unexpected fall in inflation.

In addition, the progress in information technology would indicate that credit institutions will be induced to offer increasingly "personalised" forms of loan which are increasingly flexible and open to modulation, the only constraint resulting from the necessary consistency between the loan and the resources on which it is based.

For instance, certain loans are "composite", with part of the capital at variable rate and the rest at fixed rate, others offer the borrower the option of varying the rate of redemption.

The variable nature (revisable or referenced) of the rates does not of course exclude them from competition. The principle must be to display the rate "a priori" in accordance with the figures known on the day of the offer, together, it goes without saying, with the precise conditions of variability.

Article 1a, paragraph 6, of the directive of 22 February 1990 must serve as a rule: "In the case of credit contracts containing clauses allowing variations in the rate of interest and the amount or level of other charges contained in the annual percentage rate of charge but unquantifiable at the time when it is calculated, the annual percentage rate of charge shall be calculated on the assumption that interest and other charges remain fixed and will apply until the end of the credit contract."

In the case of renegotiable loans, the rate taken into account must be that of the first phase of the loan, together with the conditions for setting the rate for the following period; the figures taken into account are still those known on the day of the offer.

3. Special forms of loans

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3.1 The "disagio"

The practice of the "Damnum" or "disagio" is analysed as a payment of interest made in advance. It is justified by the tax advantages from which it enables the borrower to benefit and which are linked to the construction phase.

For example, a loan of 100,000 DEM will only give rise to an actual payment of 95,000 DEM, the "disagio", i.e. the interest paid in advance, being 5,000 DEM.

A difficulty often mentioned by the lenders is that the loan granted with this "disagio" is often at a renegotiable rate and that the period of redemption of the loan is not certain.

There is nothing in theory to prohibit the second phase of the loan also being accompanied by a disagio, but there is nothing either to justify it, in so far as the tax advantages are linked to the construction phase prior to the occupation of the housing.

Over what period must the disagio be charged?

The rate will vary in accordance with the total duration of the loan; the shorter the duration, the higher the rate will seem.

Strict application of the equivalent method eliminates this difficulty. Indeed, it consists in equating the present values of the sums paid and the present values of the sums received. Consequently, it is logical only to consider as borrowed capital the capital effectively paid out by the bank, i.e. with the disagio deducted.

This solution, tested using sample calculations communicated by the "Verband Deutscher Hypothekenbanken" has the consequence of showing a loan with an identical APRC, whether or not it is accompanied by a "disagio".

3.2 The special case of Denmark

Danish practice has the particular characteristic that the mortgage borrower does not receive any cash directly from the lender, but mortgage bonds which he trades on the Copenhagen Stock Exchange.

The price of these mortgage bonds may vary between the day on which they are made available to the borrower and the day on which he trades them on the Stock Exchange. There is usually about a fortnight between these two dates.

It is therefore a fixed-rate loan but which contains an element of variability deriving from the trend in the price of the mortgage bonds during the time between the signature of the loan and the sale of the mortgage bonds on the Copenhagen Stock Exchange.

The rate must be assessed as in the case of a variable-rate loan, i.e. taking account of the price of the mortgage bonds on the day of the offer or of the signature of the loan contract.

3.3 The "composite loans"

- Endowment and "in fine" credit

The loan is linked to a life assurance serving to repay the capital due at the end of the loan. The borrower only pays the interest to the lender, to the exclusion of any sum intended to redeem the loan.

Simultaneously, he pays the monthly premiums for a life assurance which, at the end of the operation, will allow the borrowed capital to be reimbursed. The objective of the operation is to draw the maximum benefit from the tax possibilities and there are a large number of forms used.

- Full endowment with profits

This is the most costly form which links loan and long-term saving. It guarantees the payment of the capital on the due date or in the event of the death of the borrower, plus a tax-free lump sum.

- Low cost endowment

Less costly, it also offers the possibility of additional capital after reimbursement of the borrowed sum.

- Low start endowment

This is the same formula, but with progressive instalments

- Unit-linked endowment

The sums intended to redeem the capital are invested in an investment fund, the value of which may vary upwards or downwards; in return, it offers the possibility of easier early repayment.

- Pension-linked

The loan is linked to a personal pension scheme.

Is it possible to take account of all the financial flows, monthly instalments of loan and insurance premiums to determine the APRC for the operation?

It is impossible: insurance takes too many different forms and follows its own logic.

Nevertheless, special efforts must be made to provide information on the endowment, since the modest consumer tends to consider it as a formula, among others, for redeeming his loan; however, the risks inherent in some or the above-mentioned endowment formulae make it impossible to present an APRC calculated on the overall "loan + insurance" operation.

The APRC taken into account in the case of an endowment, or an "in fine" credit must concern only the loan phase in the strict sense of the term and not integrate the sums which correspond to insurance premiums.

3.4 Deferred credit

This is a product which exists in several Community countries (épargne logement in France, "Bausparen" in Germany, etc.), which consists in combining a savings phase and loan phase.

The rights to a loan generally depend on the savings phase.

The logical solution consists of not calculating the rate over the entire operation, but in drawing a distinction between the rate for the savings phase and the rate for the loan phase. In this case, even if the loan bears an attractive rate, it is "out of the competition" because to obtain it, it is necessary to have undertaken a savings phase beforehand.

Another deferred credit technique was used in France, which must be mentioned pro memoria; it associated, simultaneously, a savings phase and a loan phase, thanks to a so-called "anticipatory" credit.

This technique is no longer practised; for the borrower, it appeared as a single operation and the rate should have been calculated over the whole of the operation (savings, loan, anticipatory credit) from the present values of the payments by the borrower.

3.5 The opening of mortgage credit lines

Another case must be covered, that of mortgage loans with no fixed duration.

The bank offers the borrower a drawing right which he can use, as he chooses, to draw and to repay.

The only problem arising from the calculation of the rate derives from the anticipated duration taken into account to charge the administrative costs.

Since the length of the loan contract is not fixed, the same solution must be adopted as for consumer credit: article 7, paragraph 2, specifies that "if there is no fixed timetable for repayment, and one cannot be deduced from the terms of the agreement and the means for repaying the credit granted, the duration of the credit shall be deemed to be one year".

In the case of a short-term mortgage loan, as in the case of bridging loans, this solution is perfectly fair.

On the other hand, if the mortgage credit line corresponds in fact to a long-term loan, the charging of the administrative costs over just one year results in an artificial rise in the rate; in such a case, it is in the bank's interests to present its product in the form of a loan for a specific period, accompanied by perfectly flexible conditions for unblocking funds and early repayment.

Besides, it is appropriate to provide that, where a contract has been concluded between a credit institution or a financial institution and a borrower for the granting of a loan in the form of an advance on current account, the borrower is informed in writing at the time of concluding the contract or before this:

- of the possible ceiling on the loan;
- of the annual interest rate
- of the terms under which the contract can be terminated.

In addition, during the contract, the borrower is informed of any change in the annual interest rate or the costs at the time this change takes place.

3.6 Loans at preferential rates

Article 2, paragraph 2, of the directive of 22 December 1986 on the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit provides that "a Member State may, in consultation with the Commission, exempt from the application of this directive certain types of credit which fulfil the following conditions:

- they are granted at rates of charge below those prevailing in the market and
- they are not offered to the public generally".

Provisions in the same spirit must be adopted, where appropriate, for mortgage credit.

This would be the wish in particular of the Verband öffentlicher Banken with regard to the so-called incentive credits "Förderkredit".

These are credits at advantageous rates, intended to promote housing, granted outside the market by public institutions and with characteristics which may be modified as a result of transformations of the general economic environment or the personal situation of the borrower. These loans may be brought to match market conditions as soon as the conditions for granting them relating to the person of the borrower disappear.

So far, the definition of an annual percentage rate of charge for this type of loan does not present any particular difficulties: it suffices to apply to them the principle adopted for all variable loans and to display the conditions known on the day of the offer, together with the precise conditions of variability.

If it does not present any major difficulty, the application of the directive to this type of credit does not present any particular interest either, in so far as it is outside the scope of competition.

III. CHARGES: THE COSTS INVOLVED

1. Cost allocation criteria
2. Ancillary costs

The main problem in comparing rates lies in the definition of the costs which must be taken into account in the calculation of the APRC:

- the ancillary costs and the services which they cover vary considerably and often correspond to national practices
- the exact amount of some of these costs are not known until the loan agreement has actually been concluded.

Therefore what criterion must be adopted to identify the costs to be taken into account when calculating the APRC?

1. Cost allocation criteria

A simple, fair and logical rule must enable one to distinguish easily between the ancillary costs which must be included in the calculation of the rate and those which must be excluded.

1.1 Presentation of the "bare" rate

One solution might be to take account only of the rate arising simply from the payment of interest and the redemption of the capital.

This would be unacceptable since other costs, notably those charged by the lender, for instance handling charges, are an essential element in the cost of the loan.

This is often how national publicity works: the figures for rates do not include costs or insurance.

More generally, this information is all the more inadequate for carrying out a comparison once one realises that different ancillary costs are charged by institutions in the various countries.

1.2 "Compulsory" costs connected with loan agreements

All the costs which must be paid in order to obtain a loan must be included in the calculation of the APRC.

This is the principle used in consumer credit; it is also used in France for mortgages.

It may however lose all meaning in a European context.

In fact, compulsory costs are often the same within a given country, but vary widely throughout the Community.

Such charges are often connected with the services available to a borrower in a particular country, although in some countries these are separate from the loan agreement.

A particularly important example of this is insurance.

When examining the file of an applicant for a loan, French banks, unlike British banks, traditionally pay more attention to the solvency of the borrower than the amount of the mortgage. In France, life insurance must be taken out by borrowers, whereas in Great Britain fire insurance for the mortgaged property is compulsory.

Does the criterion of obligation mean that the cost of fire insurance is included in the rate of the loan? This is normal practice in Ireland.

However, this is not the case for loans subscribed to from institutions in countries where fire insurance is not compulsory. Yet it is probably true to say that property is insured against fire, all the same.

Moreover, loan agreements frequently mention the obligation for the borrower to insure the property, but this is the business of the borrower.

Furthermore, certain ancillary costs - even compulsory ones - often correspond to very heterogeneous services: the case of insurance against unemployment is important as it covers a wide variety of guarantees.

In some cases, lenders make this a condition for obtaining a loan.

Draft national legislation is being examined in two countries - Great Britain and the Netherlands - with a view to prohibiting mortgage lenders from tying certain services to loans.

If this legislation is passed, it would mean a very clear separation between the loan on one hand and the ancillary services on the other, with an obligation being introduced to supply detailed specific information on the services.

While this is logical in a national setting where practices are homogenous, the criterion of

"obligation" would be difficult to apply from the point of view of a comparative choice in a multi-national environment.

1.3 The cost of services "designed" for borrowers

Another method of identifying the costs taken into account in the loan could be to determine who will benefit - the lender or the borrower - from the relevant services supplied.

For instance, it can be agreed that the expert appraisal of a building is of benefit first and foremost to the bank, which is assured of the quality of the property it is mortgaging. In some countries, it is even necessary in order to determine the amount of the loan.

But this criterion is not effective either: the life insurance policy is a guarantee for the bank as well as for the borrower. The bank is guaranteed that its loan will be repaid in the event of the death of the borrower, but on the other hand the heirs, and where appropriate the spouse, are assured of receiving a property which has been fully paid up.

This criterion does not distinguish all the ancillary costs and consequently cannot be used.

1.4 The costs charged by the lender

Costs connected with a service will be included in the calculation of the rate, if the price of the service is charged, or even simply passed on, by the bank.

For instance, charges linked with insurance or the expert appraisal of the property would be included in the rate if these are charged by the lender.

This solution is not satisfactory either: it would induce banks to avoid systematically acting as the sole entity for organising several services connected with the loan.

1.5 Costs charged by the lender for its own account

This is the criterion favoured by most institutions and it is certainly the easiest one to apply, but it does not at all go as far as certain national laws on APRC.

Moreover, it does not distinguish accurately and in every case those costs that must be included in the calculation of the rate.

Therefore it is necessary to review all the costs that can be included in the loan agreement.

2. Ancillary Costs

Apart from the amounts aimed at repaying the capital and covering the interest, what other elements can be taken into account to determine the cost of mortgage credit?

- . handling charges and fixed charge
- . brokerage costs
- . cost of expert appraisal of the property
- . cost of constituting mortgage guarantee
- . cost of security and subscription to guarantee or reserve funds
- . subscription of shares
- . personal insurance by borrower (life, health insurance)
- . insurance against unemployment
- . insurance of property to be mortgaged
- . credit insurance premiums
- . taxes, levies and stamp duty.

Handling charges, fixed charge and brokerage costs

These are always taken into account, except in Italy, Portugal and Ireland.

The cost of handling charges is as high for borrowers as the payment of interest: as high and sometimes higher since several Member States grant tax relief on interest payments.

- Fixed charge

This charge no longer exists: in France, before the Neiertz law was adopted, it corresponded to a fraction of the handling charges explicitly excluded from the calculation of the rate and only concerned consumer credit.

The reason for it was the constraint arising from the approximation between the new equivalent method and the definition, since amended in 1989, of the usury rate.

- The "disagio"

The case of the "disagio" was discussed in the chapter on the method of calculation: it would be possible to consider this as a component of the handling charges and it would then be taken into account in calculating the rate. It is more logical to consider it as capital borrowed than as capital effectively paid, in other words account is not taken of the "disagio" (see above).

Brokerage costs

This is the cost of marketing the loan. From the point of view of the cost of the credit, it is immaterial to the borrower whether the lender chooses an internal or external sales system for its products.

Thus brokerage costs should be included in the rate.

If a regulation were adopted, all the institutions questioned by the Mortgage Federation of the EC, with the exception of Ireland, agreed that handling charges, the fixed charge and the brokerage commission should be included in the calculation of the APRC.

These costs are directly linked to the constitution and marketing of the loan.

Cost of expert appraisal

This cost concerns a guarantee which the lender wishes to have: in some countries, it is even necessary to have the property appraised in order to determine the amount of the loan. The result of the appraisal is used as a basis for calculating the ratio between the amount of the loan and the value of the mortgaged property. The rate applied to a given operation is often based on this ratio.

Expert appraisal costs should be included in the cost of credit, even when the appraisal is conducted by an independent organisation.

A majority of the members of the Mortgage Federation agree with this.
In favour: Belgium, Great Britain, Denmark, Spain, France and Ireland. Germany and the Netherlands are against.

Cost of constituting mortgage guarantee

These are included in Belgium, Denmark, France and Great Britain.

Most of the members of the Mortgage Federation are against this, with the understandable exception of the "common law" countries where notaries do not play a part in the transactions.

The refusal of lenders to include the cost of constituting a mortgage guarantee may be explained by several factors:

- these expenses are not charged by the bank for its own account; the lenders are in favour of this criterion of sharing (see above)
- these costs do not depend on the lending institution but rather on the location of the property, and are totally "external"

- they are rarely known precisely before the signing of the loan agreement.

Moreover, Germany has two types of real guarantees: the traditional mortgage and the "Grundschild" land mortgage.

The "Grundschild" is a mortgage that is dissociated from any claim and is of indefinite duration. The borrower may bring this land charge to the bank, sign a loan agreement and a security contract - "Sicherungsvertrag". He recovers the land charge when the loan is repaid and can keep it in his possession for subsequent use. Under this system, the mortgage guarantee is therefore constituted beforehand and completely separate from the claim: obviously the cost of this cannot be included in the calculation of the APRC.

Luxembourg has a very different system as far as legal basis is concerned, but close in terms of the effects: the deed opening the credit signed before a notary is similar to a mortgage credit framework contract, to which one or more private contracts are attached which specify the characteristics of the loan(s) which will actually be granted.

Moreover, the cost of constituting the mortgage guarantee depends on the location of the property, not the lending institution. In this way, it is not a competing element unless the mortgage is competing with a loan combined with another type of guarantee.

Including this type of cost may constitute a slight hindrance for cross-border competition as the "foreign" institution would have to make costly efforts to find out exactly the amount of these expenses.

The cost of constituting a mortgage guarantee is a major part of the cost of the credit for consumers: but from the point of view of the APRC, the treatment of this cost cannot be dissociated from that of other forms of guarantee.

A mortgage loan may in fact be in competition with a building loan combined with another sort of security - a guarantee (French: "caution") for instance.

Cost of security and subscription to guarantee or reserve funds

The Mortgage Federation did not question its members about the costs connected with alternative or complementary types of security, such as guarantees ("cautions").

Yet guarantees must certainly be treated in the same way as mortgages, with which they may be in competition.

The problem is complicated by the fact that the cost of the guarantee can be broken down sometimes - this is the case with French mutual benefit systems - into two parts: one part acquired by the organisation and one part refundable to the borrower once the loan has been fully paid up, the amount refunded depending on the global claims by that generation of borrowers.

The French solution is to include the part acquired by the security organisation in the calculation of the APRC, but not the part refundable to the borrower.

This solution has the merit of simplicity but is only partly satisfactory as the refundable part is only partly refunded and, in any case, in nominal value, in other words eroded by inflation.

Whether or not they are included in the rate, the cost of constituting the mortgage guarantee must be treated like other types of security. A majority of lenders object to including them in the calculation of the rate. This issue cannot be settled independently of the question regarding the phase during which the calculation of the rate is performed: the information available is not the same for an advertised offer very much upstream of a possible transaction and that available during the drafting of a loan agreement (cf. below).

Subscription of shares

The subscription of shares, a normal practice in mutual benefit organisations, is difficult to include since while it may sometimes be obligatory in order to obtain a loan, it rarely relates to this

single loan but entitles the holder to other banking services.

Personal insurance premiums (life, health, unemployment) that are obligatory and in favour of the lender

These are included in France and Ireland.

These cover a wide range of guarantees and while they certainly constitute an element in the cost of the credit, they may obscure the comparison of rates in a heterogeneous environment such as that of the Member States.

The reluctance of lending institutions seems quite justified for this reason. Only Ireland wishes to include these costs in the APRC.

The consumer credit directive states that the following are included in the calculation of the APRC: the cost of insurance or other security aimed at assuring the lender that an amount equal or lower than the total amount of the credit, including interest and other charges which the lender is obliged to require before granting the loan, will be reimbursed in the event of the disability, illness or unemployment of the consumer.

Insurance premiums covering the financed property (fire)

These are included in Ireland; Denmark and Great Britain would also like to have them included.

The problem, already mentioned above, is that the borrower is obliged to pay this insurance in every country but the cost of this will not affect the rate except in countries where the lending institution makes this an obligation controlled by it.

Credit insurance premiums

European institutions rarely make use of credit insurance.

In any case, this forms part of the constitution of the loan and must as such be included in the rate.

Taxes, levies and stamp duties

Taxes, levies and stamp duties must be treated like the elements that form the basis of the collection of these.

Where their base is connected with an element whose cost must be included in the rate, they must also be included there.

IV. OTHER FACTORS FOR ASSESSING A LOAN

1. Prior repayment and rescheduling
2. Allied services
3. Various penalties
4. Possibility of transferring loan
5. Exchange risks

The life of a loan is subject to events that cannot be predicted and often concern the borrower himself.

An important element in assessing the quality of a loan is to know to what extent the borrower can change the conditions during the repayment period.

1. Prior repayment and rescheduling

The possibilities of repaying a loan in advance vary considerably from one country to another.

The Mortgage Federation has also established a very comprehensive report on the practices in this area.

There are two main points.

One factor, common to all countries, establishes a link between the possibility of repaying a loan in advance and the type of resources backing it: for instance, can a variable rate loan usually backed by scant resources always be reimbursed?

The main difference concerns fixed rate loans: it should be borne in mind that in order to lend the money, the banker himself has undertaken commitments which he cannot shed.

Therefore he will be penalised if the market rates have dropped between the time when the loan was granted and the time it was repaid.

Germany and France have adopted diametrically opposed positions in this area: Germany prohibits prior repayment to preserve full consistency between the duration of the loans and that of the resources, while France always permits prior repayment and imposes a ceiling on the compensation payable to the banker: 3% of the capital outstanding.

This is an essential factor which must be taken into account when making a comparison of the different types of credit on offer, but it is not however possible to take account of it in calculating the APRC.

Standardised information on the possibilities and exact cost of prior repayment is essential.

2. Allied services

One of the elements for which it is most vital to obtain information, without however being able to take this into account in calculating the rate, is the services allied to the loan in the strict meaning of the term.

"Endowment" or in fine credit is the most typical: the rate of the loan reflects the cost of the interest only while the capital is repaid by means of a life insurance contract. Financially speaking, these two operations are inseparable. It is essential that consumers should be aware of all the obligations they are undertaking.

3. Various penalties

National laws on this vary significantly. Penalties imposed in the event of incidents regarding repayments are either regulated or contractual, depending on the country in question.

The increase in claims connected with an increase in risks regarding mortgage loans throughout Europe means that account must also be taken of this aspect.

But it is not possible to take account in the APRC of the weight of the penalties incurred by the borrower if he does not fulfil his obligations for any reason whatsoever.

The directive must include an obligation regarding information in this respect: the borrower must have a precise idea of the penalties involved if he does not honour his commitments.

4. Possibility of transferring loans

Rather than repaying the loan in advance, the borrower may be tempted to transfer it:

- transfer from one property to another
- transfer from one borrower to another.

In any case, it is quite legitimate for the lender to reserve the right to approve the new debtor, who might be less solvent, as well as the new property, whose value might be lower.

In the case of a variable rate loan, this operation will be possible but will only save a few expenses.

In the case of fixed rate loans, the operation will only be interesting for the borrower compared with a new loan if it is disadvantageous for the lender, in other words in the event of an increase in the rates between the date of subscription and the possible date of transfer.

This means that transfers rarely occur in practice.

6. Exchange risks

This is an element that has nothing to do with the loan and obviously cannot be taken into account.

Moreover any law on this aspect would be based on the prospect of a single currency.

However, the desire to protect consumers induces us to recommend the British formula.

When a loan guaranteed by land must be repaid in a foreign currency, the advertisement, whether interim or complete, regarding the credit must mention the following statutory warning:

"The equivalent in pounds sterling of your commitment in foreign currency may be increased following fluctuations in the exchange rate."

PART THREE A PROPOSAL CONCERNING THE DISPLAYING OF LENDING CONDITIONS AND INTEREST RATES

- I. Consumer information and fair competition
- II. The various stages of the borrowing operation
- III. An effective "global" rate?
- IV. Effective labelling

I. CONSUMER INFORMATION AND FAIR COMPETITION

The objective of a directive on displaying interest rates for mortgage credit is twofold:

- to improve consumer information and protection
- to define the conditions of fair competition between the various lending institutions in the Member States.

The wish to improve consumer information has led to the choice of a method which guarantees consumers knowledge of the total cost of their borrowing operation: this militates in favour of a "broad" definition of the APRC taking account of all the costs linked with the loan.

On the other hand, the imperative of fair competition requires a common measurement device. The comparison must be based on the most homogenous data possible. For this reason the definition of the rate must be relatively narrow. Most of the lending institutions are clearly in favour of this.

In this case, the definition of the APRC in Community countries would, at least with regard to the charges involved, lag far behind the most protective rules laid down in certain Member States.

A European rule in such a technical area risks being replaced by the more protective rules which may exist in some Member States. In fact, it is difficult to imagine two definitions of the APRC existing alongside each other, one obeying national rules and the other one Community rules.

II. THE VARIOUS STAGES OF THE BORROWING OPERATION

However, these two objectives - better information and fair competition - refer to two different phases of the act of borrowing.

Upstream, the choice between the offers by several lending institutions can only be based on relatively restricted information concerning the ancillary costs that will affect the cost of the loan. Costs connected with the actual operation or the person of the borrower will only be known once the operation is sufficiently advanced and examined by the pre-selected lender.

Thus in countries like France that have a very broad definition of the APRC, which includes insurance costs and the cost of constituting the mortgage guarantee, there are advertisements for an APRC net of charges. Consumers do not really make use of the APRC as a comparative tool in these countries.

This would induce us to exclude two types of elements from the "Community" APRC:

- those supplied in return for very varied and heterogenous services: insurance connected with the borrower (life, health, unemployment) and with the property (fire).
- those which are connected more closely with the building being financed and its location than the loan, strictly speaking: the cost of constituting a mortgage guarantee. The desire to treat the various forms of security (mortgage or guarantee) equally would lead to the exclusion of the cost of the security bond from the rate.

However, further on in the operation, consumer information and therefore protection requires that when concluding the loan agreement, the borrower must have detailed knowledge of all the charges he will have to pay. He must also have comprehensive information on all the characteristics of his loan.

III. A GLOBAL EFFECTIVE RATE?

1. The decision regarding homogeneity

As can be seen, the proposed solution follows the same logic as the consumer credit directive. It is an extension of this, in fact, but with one change.

This change means a solution that is lagging behind in order to take account of the diverse practices in Europe in the domain of mortgage credit:

- lagging behind with respect to the consumer credit directive
- lagging behind with respect to the most protective laws adopted by some countries.

The desire to compare homogenous rates would result in excluding from the APRC expenses which are nevertheless constituent elements of the cost of the credit, insurance, and the cost of constituting a guarantee and therefore of defining an effective annual rate which is not really global, an "APRC net of insurance and net of security".

This solution would not go as far as the directive on consumer credit which states that the following are included in the calculation of the APRC: the cost of insurance or securities aimed at assuring the lender that an amount equal or lower than the total amount of the credit, including interest and other charges which the lender is obliged to require before granting the loan, will be reimbursed in the event of the disability, illness or unemployment of the consumer.

However, the directive should require that certain information other than the APRC, a list of which may be precisely defined (see below), must be supplied to the borrower in a standardised form.

It might also state that the calculation of the insurance rate and security should be contained in the contract together with the APRC.

2. The list of costs included in the APRC

Apart from the amounts destined for the repayment of the capital and payment of the interest, the "APRC, net of insurance and securities" should be taken into account to determine the cost of credit in the field of mortgages:

- handling charges
- brokerage charges
- expert appraisal of the property
- credit insurance premiums.

In other words, the only costs excluded from the calculation of the rate, of all the costs which the borrower must pay to obtain a mortgage loan, are the cost of constituting a mortgage guarantee or security and the costs connected with personal insurance (life insurance and health insurance, insurance against unemployment) and insurance covering the property to be financed (fire, etc.).

This is the basis on which lending institutions can advertise their rates.

IV. EFFECTIVE LABELLING

1. Information which is not reduced to the rate

The choice of a quite restrictive definition of the charges has resulted in the addition of other labelling requirements providing information on the qualities of the loan.

The following information must be contained in the loan agreement:

- The list of compulsory charges not included in the "APRC net of insurance and net of security", the cost of these and the precise definition of the services they are buying:
 - . Life insurance: cost and exact nature of the guarantee
 - . Health insurance: cost and exact nature of the guarantee
 - . Insurance against unemployment: cost and exact nature of the guarantee
 - . Cost of constituting a mortgage guarantee: cost
 - . Security: full cost with indication, where appropriate, of the refundable part
 - . Fees, taxes and stamp duty not included in the calculation of the rate.

- The amount of the costs to be borne by the borrower must be clearly stated and be the subject of a calculation of the rate of "insurance and security costs included".

- Other characteristics of the loan which will probably not form part of the calculation of the rate must also be communicated.
 - . possibility and cost of possible prior repayment
 - . list of costs and description of corresponding services supplied
 - . penalties incurred in the event of non-fulfilment of contractual obligations by the borrower.

2. Formal loan offers

Whatever decision is adopted, the directive's two objectives must be achieved:

- an "APRC net of insurance and net of security" based on homogenous elements ensures fair competition
- the obligation to supply a list of additional information when the loan contract is being signed guarantees that the consumer is properly informed.

Moreover, to ensure that this second objective is achieved, the information obligation should be fulfilled in such a way that the borrower has enough time to become familiar with the information before committing himself by signing a loan agreement.

The initiation of a loan offer procedure, such as those prevailing in certain Member States could provide a satisfactory solution.

In France, for instance, the lending institution must send a loan offer to the borrower by post, the content of which is regulated. The offer is binding on the institution for thirty days. The borrower, for his part, has ten days to consider and examine the offer and, if he accepts it, must return it, signed, to the lending institution.

In other countries - this is the case in Germany for consumer credit - the period for considering the offer is replaced by a period of regret: the borrower may withdraw during the week following the signing of the loan agreement.

This type of procedure falls within a domain which affects mortgage practice in each country: therefore it goes beyond the scope of any directive on the displaying of rates.

However this would enable us to agree on a quite restrictive definition of the APRC, corresponding to the wishes of the lenders and providing the consumer with very comprehensive information to enable him to understand all the charges linked with the credit operation.

This balanced solution would take account of the wishes of the lenders' representatives as well as those of consumer organisations.

The establishment of a formal loan offer procedure would be the counterpart of a quite restrictive definition of the APRC, net of insurance and net of security.

Moreover, the French practice demonstrates that the mechanism of a loan offer does not have any real disadvantages for lenders, apart from that arising from the adjustment to new habits.

The terms of this choice - a narrow definition of the APRC but at the cost of introducing a loan offer procedure - must still be discussed with all the parties involved, representatives of both consumers and lenders, with the Commission taking the initiative in organising this.

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