

Guest Column

US mortgage crisis suggests that EC should not legislate sub-prime, pre-payment

By *Louis Hagen, CEO, Association of German Pfandbrief Banks*

Current concerns over global credit markets in view of the US sub-prime crisis have some linkage back into the debate in Europe over reforms to the mortgage sector. The Green Book of draft legislation issued by the European Commission is to be followed by a White Book of legislative proposals before year end. The EC's aim is to enhance cross-border mortgage lending. One of the points is that we in Germany and some other countries do not have a sub-prime sector and it would help to get the internal market or home finance working if we did. The question is whether this is really something that should be incentivised by legislation. If consumers want sub-prime and lenders think they can manage the risk, then there is nothing wrong with this. That's the free market. But I don't believe we need legislative pressure to do this. The important issue is whether sufficient housing exists at affordable prices for people on lower incomes or for those with a poor credit history. In Germany, we have low interest rate loans programs offered by special purpose public sector banks that provide subsidies for low or middle-income families, so the government is already doing a lot. The second issue is that Germany has a huge rental market, and rents are not very high. If someone rents there is no social problem; they are not stigmatised. So Germany is a completely different

case when it comes to the need for a sub-prime segment. The story might be different where there is either no rental market or it is extraordinarily expensive - such as London.

Neither is the argument on owning a home to help pension savings as solid as it appears. If you take out a loan and pay interest and amortisation, the interest is not saved but gone. Only the payments on the amortisation are somehow a savings factor. But if I can rent a home cheaper than the interest I have to pay on a loan then I can save money and invest in Bunds or Pfandbriefe or other comparable safe investments, and I will have an interest rate of 4%-5%. In addition, a good rental market is a prerequisite for workers to move to where they can find jobs, whereas home ownership does not improve workforce mobility. Here it is really, 'my home is my castle'. While the normal family unit in other jurisdictions has eight different houses over its lifetime, in Germany once they buy they hardly ever move again.

We are also concerned that the Commission could propose legislation

on mortgage provision - in particular a mandatory right for the borrower to prepay. Our view is that by doing this you take away a product that 90% of Germans prefer and the freedom to choose the product they want. Savings banks have the largest market share now. But even if you look at the direct suppliers using the Internet, the majority of loans they grant are fixed-term, fixed-rate mortgages because that is what the German customer wants. While Germans are seen as not being liberal, I believe



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that the opposite is the case. In Germany you can have a mortgage loan pre-payable at any time: A mortgage loan with adjustable interest rate, fixed interest rate, a mortgage loan where you choose to prepay after one year, two years, three years - whatever you want. Others, like the French, are more restrictive because there, by law, the customer must buy the option to prepay whether he wants it or not. In Germany, the customer buys the prepayment option at 30 to 50 basis points more, and has the right to say no, I don't want it. So why take this away from the market? I don't see this as restrictive at all. Ih