

The Protection of Mortgage Loan Consumers in Albania

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Abstract: *This paper for protection of mortgage loan consumers (As per Consumer Credit Directive 2008/48 /EC and EU Directive 2014/17/EU “On credit agreements for consumers relating to residential immovable property”, “CONSUMER means a natural person who, in transactions covered by this Directive, is acting for purposes which are outside his trade, business or profession”)in Albania, analyses ten main uprisings of new regulation “On consumer loan and mortgage loan” and the regulation “On transparency for banking and financial products and services” which enforce the mortgage credit consumer protection attempting to harmonize the rules for mortgage credit with EU Directive 2014/17/EU “On credit agreements for consumers relating to residential immovable property” and Consumer Credit Directive 2008/48 /EC. Therefore, these regulations contribute in protecting the financial health, safety and economic interests of consumers, as well as promoting their rights for information and financial education and for organizing themselves in order to safeguard their interests, concluding that Albania as an EU candidate country has at least completed the mission in the area of mortgage loans regulation. This paper aims to inform banks, consumers, researchers, consumer protection organizations and other stakeholders for the importance of these regulations as well as raising some other related issues to be considerate for the protection of mortgage loan consumers.*

Keywords: Consumer, mortgage loan, responsible lending, financial education, early repayment rules, bank.

1. Introduction

In 2014, EU political reasoning moved towards achieving a high level of consumer protection, safeguarding mortgage markets and hence preventing a second mortgage crisis, due to the current financial crisis, which had its origin in the malfunction of some mortgage markets. Albania either as an EU candidate country or as a country with the majority of banks having their mother banks from EU countries, is attempting to harmonize the rules for mortgage credit with EU Directive 2014/17/EU “On credit agreements for consumers relating to residential immovable property”.

According to data on December 31st 2014, in Albanian banking market the retail credit loans (consumer credit loans [Which means credits for consumption purpose not for housing.] and mortgage loans) were around 991 million euro, consumer credit loans were around 26 per cent of them, while the rest about 74 per cent were mortgage loans. Also, mortgage loans accounted 18.7 per cent (or 734.45 million euro) of the total credit loans in Albania and the size of the mortgage loans market, in comparison to the Albanian GDP was at 7.4 per cent of GDP (As per Dec. 31st, 2014). The other fact is that regarding the consumer protection, the Law No. 9902 of 17 April 2008 “On Consumer protection”, amended by Law No.10444 of 14 July protects only consumer credit loans, leaving out of protection the mortgage loan consumers.

In 1984, the European Commission published its first working paper on the freedom of establishment and freedom to provide services in the area of mortgage credit. In December 1984, the European Commission published its proposal for the first Mortgage Credit Directive (Proposal for a Council Directive on the freedom of establishment and the free supply of services in the field of mortgage credit, COM 84 730 final). In 2001, the European Banking Federations and the Consumer Organizations signed the so called European Agreement on a Voluntary Code of Conduct on Pre-Contractual Information for Home Loans.

The main element of this Code was the elaboration of a pre-contractual information sheet with EU-wide harmonized information standards. These information elements should enable the consumer to compare offers on a cross banks basis and to enable consumer to make an informed choice before signing a mortgage credit contract. After many years of consultation (Report on the Integration of the EU Mortgage Credit Markets from 13.12.2004 or the so called Mortgage Industry and Consumer Dialogue (MICEG) and the Mortgage Funding Expert Group (MFEG) from 22.12.2006), a Green Paper (Green Paper on Mortgage Credit in the EU, COM(2005)327 from 19.07.2005), a White Paper (White Paper on the Integration of EU Mortgage Credit Markets COM(2007)807 from 18.12.2007) and several studies (Study on consumer testing of a possible new format and content for the European Standardized Information Sheet (ESIS) on home loans from October 2009, Study of the role and regulation of noncredit institutions in EU mortgage market from 2.12.2008, Study on equity release schemes in the EU from 18.03.2009, Study on the costs and benefits of different policy options for mortgage credit from 31.03.2012), the European Commission proposed the so called Proposal for a Directive on credit agreements relating to residential property. On 23 April 2008, the Directive 2008/48/EC “On credit agreements for consumers and repealing Council Directive 87/102/EEC” was issued/approved, regulating the level of consumer protection. On 4 February 2014, the Directive 2014/17/EU “On credit agreements for consumers relating to residential immovable property” is according to the EU law makers, an appropriate answer to the financial crisis (The European mortgage crisis affected negatively the financial crisis mostly by the subprime crisis in the United Kingdom and in Ireland, foreign currency lending in Romania, Austria and Hungary and the oversupply of housing and lending in Spain). These Directives contain measures focusing on the process leading to the signing of mortgage credit agreements, such as advertising, information provision, creditworthiness assessment, advice and measures providing for a sound regulatory framework for the market

players involved in the granting of mortgage loans. On August 29th 2008, Supervisory Council of Bank of Albania approved the regulation "On transparency for banking and financial products and services" approaching with Directive 2008/48/EC. On July 1st 2015, Supervisory Council of Albanian Central Bank approved the new Regulation "On consumer loan and mortgage loan" approaching with Directive 2014/17/EU.

2. Ten main uprisings of mortgage credit regulations in Albania.

The main uprisings of new regulation "On consumer loan and mortgage loan" and the regulation "On transparency for banking and financial products and services" which enforce the mortgage credit consumer protection, are:

1. Increased financial education. The financial illiteracy of consumers is identified as one of today's main problems. Therefore new principles on financial education have been included, according to which the banks, together with stakeholders, should devote more attention to financial education and the creation of information documents for mortgage loans. Banks have to ensure that measures will be in place to support the education of consumers in relation to responsible borrowing and debt management. Also, other stakeholders (as Albanian Banks Association, Consumer Protection Agency, other Non-Profit Consumer Organizations, Central Bank, etc.) have to be involved in the design and development of these measures in the future in order to fulfill these obligations.

2. Business conducts standards. These regulations have some general rules of business conduct in order to guarantee that banks perform their business towards their customers with a high level of ethical and moral standards. Banks either shall ensure that information, terms and conditions of loans, the clients' rights and responsibilities are complete, accurate and disclosed clearly and clearly visible at their websites and their work premises or shall explain to their customers all possible risks which they may encounter while using any of the offered loan products. Also, banks shall submit to the Central Bank of Albania quarterly reports on the interest rate applied on loans. These reports are published by the central bank in a summary format, which offers the clients the possibility to compare the loan interest rates applied and reported by each bank in Albania.

3. Rules for pre-contractual information and the right of withdrawal/reflection periods. In order to prevent consumers taking hurried decisions, the regulation "On consumer loan and mortgage loan" has a standardized pre-contractual information sheet and a period of withdrawal/reflection; i.e. a period of at least seven days for keeping unchanged the terms and conditions of pre-contractual information in the pre-contractual phase and also a period of seven days for the right of withdrawal/reflection after the approval of the mortgage loan. The standardized pre-contractual information sheet will allow consumers to compare credit offers from lenders all around Albania. With regard to the withdrawal/reflection period, the consumer must in all cases have at least seven days period

withdrawal/reflection period following the conclusion of the contract.

4. Creditworthiness assessment of potential borrowers. The mortgage crisis proved that some borrowers' creditworthiness checks were not carried out sufficiently. For assessing the creditworthiness, the borrower's expenses are to be considered and Credit Registry Databases may be consulted for every case. If the credit application is rejected on the basis of consultation with the database, the bank must inform the consumer immediately and without charge of the result of such consultations (Regulation "On consumer loan and mortgage loan", article 6/6 "The Bank shall inform consumer in case the credit application is refused by providing the respective reasons").

5. Loan-to-value and property valuation. Even, the Directive 2014/17/EU did not have any European wide standard for loan-to-value, or loan-to-income limits, as proposed by the Financial Stability Board (Principles for Sound Residential Mortgage Underwriting Practices from the Financial Stability Board (FSB) dated 18.04.2012). The existing rules provide that sound valuation practices to be applied in accordance with international standards and methods. The importance of sound regulation and oversight of appraisers is also recognized and ensure that the valuation can be carried out by appraisers employed by the bank or appoint external appraisers (In Albania, Regulation No. 62 "On credit risk management from banks and branches of foreign banks"). This valuation must be documented and retained by the bank. The European Banking Authority (EBA) will now have to lay down corresponding European wide supervisory standards in this respect.

6. The duty of banks to grant advice and explain the credit contract to the customer. The pre-contractual information may not be enough to protect consumers when they take one of their most important decisions of their financial life. The regulation "On consumer loan and mortgage loan", article 6/3 and 6/4 sets some rules (Under the influence of the mentioned EU Directives which inspired by the British Banking Code from 1992, or the Responsible Lending Standards from the British Office of Fair Trading from 2009) for advising customers. It is now stipulated that the consumer must be informed in advance as to whether or not advice is provided. Banks have to recommend the most suitable product in their product range. If any advice is provided, the result of this advice must be supplied to the consumer on paper or in a sustainable/durable medium (According to Directive 2008/48/EC, 'durable medium' means any instrument which enables the consumer to store information addressed personally to him in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored). The obligations to provide explanations of the pre-contractual information are now consistent with the requirements of the Consumer Credit Directive 2008/48/EC. Banks have to provide adequate explanations of the proposed credit agreement to the consumers in order to enable them to assess whether the proposed credit agreements are adapted to their needs and to their financial situation. These explanations include pre-contractual information (including the type of loan, amount,

currency, APR/EIR [APR(annual percentage rate) or called EIR (effective interest rate) means the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit.]), the essential characteristics of the products proposed and the specific effects they may have on the consumer. They should also include the consequences of consumer defaults, etc.

7. Early repayment rules: One of the major issues for banks and consumers in Albania has been the rules on the right to repay a mortgage loan earlier and the limits on early repayment compensation. Banks in Albania in general recognize the right of consumer to repay early the total loan and set the compensation for early repayment to a certain limit approximately around 2 to 5% of the early repayment amount. As per article 25 of Directive 2014/17/EU, the central banks as regulators have to oblige banks to accept the early repayment of loans and if banks accept the early repayment of a fixed interest rate mortgage credit, they have the right to get compensation. But, the European Union through Directive 2014/17/EU did not deal with putting caps for the early repayment penalties of mortgage loans as the United States of America did under the Dodd-Frank Act. In January 2014, the Dodd-Frank Act also changed the rules on compensation for early repayment for mortgage credits. In the Dodd-Frank Act, a distinction is made, for the first time, between two categories of mortgage; the aim being to provide the credit industry with incentives for responsible lending. To that end, mortgages are classified as either “qualified” or “not qualified”. Qualified Mortgages (QM) are based on some common-sense ideas: The borrower should be able to repay the loan; the terms of the loan should be safer for borrowers; the loan should also be easier to understand. That means you won't see QMs with complicated and risky features such as negative amortization or interest-only periods. To get a standard Qualified Mortgage, consumer monthly debt-to-income ratio generally must be at or below 43 percent. This means that no more than 43 percent of consumer gross monthly income is needed to pay consumer fixed debts including mortgage loans and other debts such as car loans. In the Section 1414 (3) of the Dodd-Frank Act are specified the caps for the early repayment penalties of “qualified mortgages”. During a one-year period beginning from the date the loan is consummated, the prepayment penalty may not exceed an amount equal to 3 percent of the outstanding balance of the loan. During the second year, the prepayment penalty may not exceed an amount equal to 2 percent of the outstanding balance of the loan. After the end of a three-year period, no prepayment penalty may be imposed on a qualified mortgage.

In Albania, with the regulation “On Consumer Loans and Mortgage Loans”, in principle the consumer has the right to repay early the whole loan or part of it. In such cases, banks may not impose any penalties, but are granted a right to compensation not only for the long term fixed interest rate agreements but also for long term variable interest rate agreements. However, the new regulation “On Consumer Loans and Mortgage Loans” in Albania limited the right of banks for compensation in case of early repayment of mortgage loans to a maximum of 2% of the early repayment amount. Also, the consumer must be informed in a

transparent manner and before the signing/conclusion of the mortgage credit agreement, about the method used to calculate the compensation for early repayment or the corresponding amount of the compensation for early repayment. According to article 13/4 of this regulation, the bank shall provide the consumer within 7 calendar days after the receipt of the request, on paper or on another durable medium, with the information necessary to consider that option. That information shall at least quantify the implications for the consumer of discharging his obligations prior to the expiry of the credit agreement and clearly set out any reasonable and justifiable assumptions used.

8. The definition of the APR (annual percentage rate) or EIR (effective interest rate). One of the main elements for regulating mortgage credits is the setting up of uniform standards in order to calculate the price of the loan - the effective interest rate (EIR/APR). In order to enable consumers to compare the price of the loan, the regulation “On transparency for banking and financial products and services” obliges banks to apply a uniform mathematical formula for the effective interest rate (EIR/APR). According to the regulation “On consumer loan and mortgage loan” all costs of the mortgage loan should be included in this calculation using the uniform mathematical formula given on the above mentioned regulation. But, these regulations do not oblige banks to offer the consumer the right to convert the mortgage loan from one foreign currency to the currency of his/her incomes, for example in case of depreciation of the national currency when the incomes are in national currency and the mortgage loan is denominated in a foreign currency. As per Directive 2014/17/EU, in case of a foreign currency loan, it is necessary in addition - bank - to indicate an APR (or EIR) which includes a possible depreciation of the national currency of 20 percent in comparison to the currency of the loan agreement.

9. The currency of mortgage loans and the interest rate (fixed or variable). In the context of the current foreign currency lending crisis, the new regulation “On consumer loan and mortgage loan” obliges banks to advise their consumers for the currency of the mortgage loans, type of interest rate (fixed or variable), etc. In this context, it is clear for banks to advise their consumers to get mortgage loans in the same currency of their incomes (Taking in consideration that a part of Albanian mortgage consumers are leaving and working abroad). This will protect consumers and banks at the same time. But, this regulation did not oblige banks in case of foreign currency loans, to give the right to consumers, under certain conditions, to change the currency of their mortgage loan (As per Directive 2014/17/EU, article 23). In the context of the variable interest rate agreements, this regulation obliges banks to advise their consumers for the interest rate (fixed or variable) but it did not go further in regulating the combination of interest rates changing from fixed rates to variable rates (Since the introduction of the Risk Limitation Act (Risikobegrenzungs-gesetz) of 12 August 2008, German law, for example, states in Section 492a of the German Civil Code: “If a fixed interest rate is agreed in the loan contract, and if the fixing of interest ends prior to the time determined for repayment, the lender shall inform the borrower at the latest three months prior to the

end of the fixing of interest whether he is willing to reach a new agreement as regards interest and if so, on what terms.”).

10. Ensuring that bundling practices (In the context of the Directive 2014/17/EU means the offering of one or more ancillary services with the credit agreement in a package where the credit agreement is not made available to the consumer separately) **do not distort consumer choice and competition in the market.** Given the particular characteristics of credit agreements related to residential immovable property, it is common practice for creditors to offer to consumers a set of products or services which can be purchased together with the credit agreement. While a combination of credit agreements with one or more other financial services or products in packages can benefit consumers, it may negatively affect consumers' mobility and their ability to make informed choices, unless the components of the package can be bought separately. It is important to prevent practices such as tying of certain products which may induce consumers to enter into credit agreements which are not in their best interest, without however restricting product bundling which can be beneficial to consumers. In the context that bundling practices might distort consumer choice and competition in Albanian mortgage market, this is not an issue yet; the new regulation “On consumer loan and mortgage loan” did not add any restriction on the bundling or tying of other banking products with the mortgage credit agreement. However, this issue has to be kept under monitoring in the future.

3. Recommendations

- With regard to responsible lending, in addition to adequate explanation of the product, consumers need additional explanation and advice for the suitability of the type, amount and tenor of the mortgage loan in relation to their needs and their personal circumstances before taking out a mortgage. If this is not done properly by the bank, the credit risk for these mortgage loans will be suspected to go up.
- With regards to responsible lending, in addition to adequate explanation of the product, consumers need additional explanation and advice for the suitability of the currency of the mortgage loan which must be mirroring the consumers' incomes and possibilities for conversion of mortgage loans in foreign currencies into Albanian LEK (the local currency) before taking out a mortgage. It is necessary in addition to indicate an APR/EIR which includes a possible depreciation of the national currency of 20 per cent in comparison to the currency of the loan agreement. If this is not done properly by the bank, the credit risk for these mortgage loans will be suspected to go up.
- The set of information (About half of the consumers would search for at least over a month to gather information on mortgage loans before signing a contract) for mortgage loans in banks' websites should be clear, comparable and symmetric, and it should be promoted as the most important source of information about mortgages, closely followed by information provided by the bank to its consumers.

- The standardized pre-contractual information for mortgage loans should be filed in a clear way to consumers, in paper or durable medium.
- Consumers must be educated that the mortgage price comparison is the most important factor for selecting a mortgage and let them understand clearly the APR/EIR and its components, as the best way to compare prices.
- Consumers should know that early repayment opportunities and fees are one of the most important factors by consumers for selecting a mortgage loan.
- Banks should reduce the decision-making process for consumers, which generally takes place over a relatively long period creating extra costs for consumers.
- Consumers must be educated and aware that banks use the database of Credit Registry in the Central Bank to get information for assessing their creditworthiness that is why consumers have to be educated for the importance of their credit history as well.
- Banks must be clearly distanced by bundled “toxic” products, which have also affected credit institutions around the globe, which were major causes of the current crisis.
- In a near future, to be amended the existing regulation No.59 of 29 August 2008 “On transparency for banking and financial products and services” enforcing the mortgage credit consumer protection according to the Directive 2014/17/EU “On credit agreements for consumers relating to residential immovable property” focusing on the process leading to the signing of mortgage credit agreements, such as transparency, marketing/advertising, confidentiality, consumer complain, information provision, etc.
- Mortgage loan consumers are not protected by the existing Law No. 9902 of 17 April 2008 “On Consumer protection”, amended by Law No.10444 of 14 July 2011. So far for the protection of mortgage loan consumers are only the regulations approved/issued by Central Bank of Albania. In a near future, attempting the protection of mortgage loan consumers to be amended the Law “On Consumer protection” harmonizing with EU Directive 2014/17/EU “On credit agreements for consumers relating to residential immovable property” and the early repayment compensation/fees for mortgage loans might be capped as by the example of Dodd-Frank Act.

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