



European  
Commission

# Study on impacts of a possible revision of the Mortgage Credit Directive

Executive summary

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# **Study on impacts of a possible revision of the Mortgage Credit Directive**

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## 1. EXECUTIVE SUMMARY

This report presents the findings of a study conducted by ICF on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) to provide evidence and analysis to support the Commission's formal evaluation of the Mortgage Credit Directive (MCD) and in view of a possible impact assessment of the MCD.

## 2. STUDY OBJECTIVE

The core objective of the study was to explore the existence and scale of problems in the current EU regulatory framework on mortgages, including problems encountered by consumers, industry, and regulators. The study identified possible policy measures (legislative and non-legislative) that could be introduced at EU level to address the identified problems, and assessed their likely effectiveness, efficiency, coherence, and wider impacts, following the approach for an impact assessment specified in the EU Better Regulation Guidelines and Toolbox.

## 3. METHODOLOGY

The data collection for this study was conducted between February and December 2022 and included desk research, legal mapping, and stakeholder consultation. Relevant literature and data, including on market trends and on national legislation and policy, were gathered from a variety of sources and triangulated with information derived from a mixed-methods consultation comprising a public consultation led by the European Commission, and targeted surveys, interviews and workshops led by ICF. The European Commission's public consultation was launched in November 2021 and concluded in February 2022, while ICF's consultation ran from July to October 2022.

A targeted legal analysis was conducted through July and August 2022 covering the EU27 Member States. The aim of this task was to identify policy measures (legal and non-legal) implemented by the Member States that 'gold-plate' the provisions of the MCD, for instance by providing further explanation of the MCD's rules (explanatory measures) or by providing additional requirements on top of the MCD (additional measures). The national policy measures identified during the legal analysis have informed the development of policy options and served as a reference point in the baseline for the impact assessment.

### 3.1. Problem definition

The study identified ten main problems, grouped under four thematic objectives for a potential revision of the MCD. The four thematic objectives are: (A) consumer protection; (B) efficiency and competitiveness of the internal market; (C) financial stability; and (D) energy efficiency.

#### 3.1.1. Objective A: Consumer protection

Under the first thematic objective of consumer protection, six problems were identified:

- **Problem 1: Some consumers are at risk of detriment from the emergence of new products or actors in the mortgage market.** For example, a lack of adequate regulation at EU level of equity release products, comparison websites and non-bank lenders (including peer-to-peer lending platforms) is exposing some consumers to a risk of detriment.
- **Problem 2: Consumers do not fully read or understand the information they are provided during the advertising and pre-contractual stages and are unable to compare offers.** Although the MCD introduced various provisions aimed at enhancing consumers' ability to compare offers and make an informed decision,

some consumers are still being misled by unclear or misleading advertising of mortgages, especially online, and most notably via social media. The content of the European Standard Information Sheet (ESIS) is too technical for many consumers to understand, and the format of the ESIS is poorly adapted to the digital era. Furthermore, the ESIS is sometimes being provided too late in the application process to enable consumers to compare different mortgage offers.

- **Problem 3: Discriminatory data or processes may be used during the creditworthiness assessment process.** Age is a factor that is widely considered by lenders during creditworthiness assessment, even though this could potentially be perceived as discriminatory. Similarly, some lenders may consider borrowers' parental status during a creditworthiness assessment. While industry argues that the use of artificial intelligence (AI) may expedite and improve the reliability of the creditworthiness assessment process, there is literature suggesting that AI could penalise some consumers, making it harder for them to obtain a mortgage.
- **Problem 4: Some credit institutions do not offer some mortgage products unless consumers purchase additional tied services that are not necessary and do not meet their needs.** Although the MCD prohibits most forms of tying, the tying of some products remains possible and is commonplace for insurance products. Although some industry stakeholders argue that tying can benefit the consumer (enabling better deals), consumer representatives opposed this view, contending that tied products are often needless and costly for consumers. Lenders can earn large commissions from insurance providers which incentivize them to cross-sell insurance products. The widespread use of pre-ticked boxes further promotes the unnecessary cross-selling of products.
- **Problem 5: Compensation for early repayment hinders or prevents consumers from switching provider and benefitting from better offers available on the market.** Consumer organisations and public authorities have indicated that the amount of compensation to be paid to lenders for early repayment represents an important obstacle for consumers to exercise their right to early repayment and prevents some consumers from switching to cheaper mortgage deals. Compensation for early repayment represents a cost for consumers and hinders competition.
- **Problem 6: Consumers who are unable to repay their mortgage or who encounter other problems with their mortgage may be inadequately protected and incur unnecessary costs.** Although industry tended to agree that the MCD has been effective in ensuring that creditors exercise reasonable forbearance before foreclosure proceedings are initiated, consumer representatives were critical of the level of consumer protection offered by the MCD, especially the lack of alternative dispute resolution systems which may offer a quicker, simpler, and less costly route for consumers to seek redress when disputes arise. Consumer representatives were also critical of Member States' enforcement of the Directive's provisions on arrears and foreclosure (Article 28). Directive 2021/2167 (the NPL Directive) recently amended the MCD, introducing amendments under Articles 27 and 28 (including to forbearance measures), however, the effectiveness of these new requirements has not been assessed during this study.

### 3.1.2. Objective B: Efficiency and competitiveness of the internal market

Under the second thematic objective of efficiency and competitiveness of the internal market, two main problems were identified:

- **Problem 7: Some consumers who wish to obtain a mortgage in another Member State have less choice and are unable to obtain a mortgage, even when they receive their income or hold assets in the currency from which the credit is to be repaid.** Although only a small proportion of consumers opt to obtain a mortgage cross-border or in a foreign currency, there is demand for such mortgages from some social groups (e.g., cross-border workers and cross-border

retirees). There is anecdotal information that, because of the broad definition of a foreign currency loan included in the MCD, some lenders have ceased offering mortgages cross-border or in a foreign currency. Industry has indicated that this poses a barrier to competitiveness and the creation of an EU single market in mortgages. It may also be problematic for consumers that require access to foreign currency or cross-border mortgages.

- **Problem 8: There remain barriers for creditors to operate cross-border.** Although the main barriers (e.g., differing national legal and tax systems, and language) for creditors to operate cross-border lie outside the remit of the MCD, different national requirements, including gold-plating of the MCD, also create a barrier for creditors to operate cross-border. Creditors also face difficulties accessing the information they need to conduct creditworthiness assessments for cross-border mortgages.

### 3.1.3. Objective C: Financial stability

Under the third thematic objective of financial stability, another problem was identified:

- **Problem 9: There is a higher risk of non-repayment and default where the creditworthiness assessment is not conducted sufficiently rigorously.** Notably, the MCD does not specify which metrics should be used to perform the creditworthiness assessment and the European Banking Authority (EBA) Guidelines on Loan Origination and Monitoring, which include recommended metrics, do not specify the levels beyond which a mortgage application should be refused.

### 3.1.4. Objective D: Energy efficiency

Under the fourth thematic objective of energy efficiency, a tenth and final problem was identified:

- **Problem 10: The European Green Deal and Sustainable Finance Agenda are not sufficiently supported by the MCD.** The European building stock constitutes the largest single source of energy consumption and represents an important share of energy emissions. However, the MCD does not specifically support the uptake of green mortgages or introduce any specific measures to support the European Green Deal and Sustainable Finance Agenda. As a result, creditors lack incentives to offer such products, and consumers lack awareness of their availability and the incentives to take advantage of them. A compounding challenge is that the current EU legal framework omits an agreed definition of a 'green' or 'energy efficient' mortgage. Ensuing from the lack of legally binding definition of green mortgages is a lack of common EU standards to evaluate the 'greenness' of a property.

## 3.2. Policy options and the preferred option(s)

To address these ten problems, a wide range of policy measures were identified, drawing on desk research and stakeholders' suggestions during the consultation. Policy measures were grouped into a series of distinct policy options for each of the four policy objectives.

### 3.2.1. Objective A: Consumer protection

For the first objective, concerning consumer protection, five policy options were considered. These are the baseline (Option A0 – status quo) and four alternative combinations of policy measures (Options A1 to A4).

Besides maintaining the status quo, policy option A1 is the least ambitious of the options under the consumer protection objective, comprising only non-legislative measures. Under this option, guidelines would be introduced clarifying the obligations of the MCD for peer-to-peer/crowdfunding platforms and comparison websites. To help consumers compare different mortgage offers, guidelines would also be introduced indicating how the standard information to be included in advertising could be presented according to the medium

(e.g., TV, radio, social media) and format (e.g., smartphone, tablet) of the advertisement. Guidelines would also be introduced clarifying “in good time” the provision of pre-contractual information. The assessment of this option concluded that voluntary guidelines alone would not adequately address the problems experienced by consumers and so this option was discounted as the preferred option.

Policy option A2 is more ambitious than option A1. As well as the voluntary guidelines included in option A1, and described above, this option would require a legislative update of the MCD. For example, under this option, the MCD would be extended to loans where the collateral is non-residential immovable property (e.g., garages), and Member States would be required to ensure that consumers have access, free of charge, to at least one independent mortgage comparison website. The MCD would also be adapted to explicitly prohibit discrimination based on specific grounds, such as sex and disability. To prevent the cross-selling of unnecessary tied products and services, Article 12(2)(a) of the MCD would be revised to prevent creditors from the tying practice mentioned in this provision (c.f., tied payment or savings accounts). The use of pre-ticked boxes would also be prohibited. The Member States would also be required to ensure that free and independent debt advice services are made available for overindebted, or otherwise vulnerable consumers. Although policy option A2 would address many of the identified problems, it fails to address problems such as the high levels of compensation being claimed by creditors for early repayment and, for this reason, was not considered to be the preferred option.

Policy option A3 substantially broadens the scope of application of the MCD and, in most respects, is more ambitious than policy options A1 and A2. Under this option, new obligations would be introduced for loans where the collateral is non-residential immovable property, for peer-to-peer/crowdfunding platforms and for equity release products, substantially extending the protection offered by the MCD to areas not yet covered. To facilitate the comparison of different mortgage offers, Member States would be required to ensure that consumers have access, free of charge, to at least one independent mortgage comparison website. New rules would also be introduced to adapt the content of the standard information to be included in advertising to different forms of advertisement. The minimum period for reflection and/or withdrawal would also be increased from 7 to 14 days. Under policy option A3, discrimination would be explicitly prohibited by the MCD, and consumers would be given new rights when the creditworthiness is based on the automated processing and profiling of consumer behaviour, including the right to human intervention and to contest the decision. To limit cross-selling, Articles 12(2)(a) and 12(2)(b) of the MCD would be revised to prevent creditors from the tying practices mentioned in these provisions (i.e. tying of payment/savings accounts and tying of investment/pension products). The use of pre-ticked boxes would also be prohibited. Unlike Policy options A1 and A2, policy option A3 would also establish a quantitative cap on the amount of early repayment compensation that can be claimed by creditors. However, it would stop short of preventing creditors from claiming compensation altogether, due to the possibility this may increase average mortgage costs. Finally, this option would require the Member States to ensure the provision of free and independent debt advice services. Although policy option A3 would require a legislative update to the MCD and potentially also the introduction of new legislation, this option should substantially increase the overall level of consumer protection in the EU, both now and in the future.

Policy option A4 is the most ambitious option. As well as incorporating many of the measures already included in the preceding options (A1-A3), it also introduces several new and ambitious measures. This option would significantly broaden of the scope of the MCD, not only to peer-to-peer platforms, non-residential immovable property, and equity release agreements (as explained for the previous options) but also to movable residential property (e.g., caravans). However, this latter measure may be difficult to implement in practice, as a movable property represents a much less secure form of collateral for a mortgage loan. To tackle both consumer protection and competition issues, under this option, creditors would be prevented from claiming any compensation in the case of early

repayment. While this may benefit consumers that opt to switch their mortgage, industry has explained that it could lead to an increase in the average cost of a mortgage loan, as lenders seek to recoup their costs. This option would also introduce a requirement for creditors to offer additional forbearance measures where a consumer is facing financial difficulty. However, the available evidence suggests that this measure may not be necessary given the recent amendment of the MCD by the non-performing loans (NPL) Directive and the temporary measures (e.g. payment moratoria) introduced by the Member States during the Covid-19 pandemic.

Overall, policy option A3 was identified as the preferred option under the consumer protection objective. This option presents the best balance between investment and compliance costs for the affected stakeholders and benefits for consumers and the wider economy. This option also has the highest net present value among the options considered.

### 3.2.2. Objective B: Efficiency and competitiveness of the internal market

For the second policy objective, concerning the functioning of the single market, four policy options were considered. These are the baseline (Option B0 – status quo) and three alternative combinations of policy measures (Options B1 to B3).

Besides maintaining the status quo, Policy option B1 is the least ambitious option under the single market objective, comprising only three policy measures. Under this option, the definition of foreign currency loan would be limited in scope to loans that imply an exchange rate risk. Member States would be required to ensure that credit databases are kept up-to-date and that all entities that provide mortgages to consumers contribute to credit databases.

Policy option B2 is slightly more ambitious than option B1. As well as requiring Member States to ensure that credit databases are kept up-to-date and that all relevant entities contribute data to these databases, this option also establishes minimum mandatory standards for credit databases on the types of positive and/or negative information that can and cannot be used for the creditworthiness assessment. On the one hand, these measures should improve the quality of information available for creditworthiness assessment, both nationally and on a cross-border basis. In turn, this should enhance the overall efficiency and competitiveness of the single market. However, requiring credit databases to collate certain minimum information may not be feasible in Luxembourg, as Luxembourg does not yet have a credit database. Depending how this measure is implemented, there may also be a risk of incoherence between the MCD and national legislation in countries that do not allow the collection of positive credit data (Denmark, Estonia, Finland). Policy option B2 would also see the MCD amended to specify that mortgage loans can only be converted to specific currencies, however, it has not been possible to determine the effectiveness of this measure.

Policy option B3 is the most ambitious of the policy measures under the single market objective. As well as containing all the measures included in Option B2, it introduces a passport for non-credit institutions. However, industry was generally sceptical that a passport would be effective.

Although policy option B3 is expected to be the most effective in creating an EU single market in mortgages, the costs for option B3 (and especially introducing a passport for non-credit institutions) outweigh the benefits. Policy option B2 is expected to provide a similar level of benefits but with lower costs and has thus been identified as the preferred option. Overall, option B2 is considered to pass the proportionality test, adheres to fundamental rights and privacy laws and conforms with both the 'digital by default' and 'do no significant harm' principles. This option is also considered to be coherent with other EU policy and legislation.

### 3.2.3. Objective C: Financial stability

For the third policy objective, concerning financial stability, four policy options were developed. These are the baseline (Option C0 – status quo) and three alternative combinations of policy measures (Options C1 to C3).

Policy option C1 introduces only one policy measure, namely voluntary guidelines clarifying the indicators (e.g. loan-to-value ratio, debt-to-income ratio) that could be used for the creditworthiness assessment and specifying how macro-financial conditions should be considered by competent authorities in setting limits for those indicators. Although this measure is not expected to be very costly, it is also expected to provide only a very marginal benefit when compared to the status quo.

Policy option C2 goes slightly further than option C1 by introducing minimum (mandatory) rules establishing one or more key indicators that must be used for creditworthiness assessments and specifying how macro-financial conditions should be considered by competent authorities in setting limits for those indicators. This binding measure leaves some leeway for the EU, Member States, and industry on how to implement the rules and can thus be considered a flexible measure. Minimum standards would also be established setting out the types of financial and economic information that can and cannot be used for the creditworthiness assessment, which should help to ensure the rigour of the creditworthiness assessment process, and in turn ensure more prudent lending behaviour.

Policy option C3 goes further still, introducing minimum rules establishing one or more key indicators that must be used for creditworthiness assessments and specifying limits for those indicators. In this respect, option C3 offers less flexibility to the Member States than option C2. Option C3 also introduces a requirement for all creditors to consult a credit database as part of the creditworthiness assessment. It may not be possible to implement this measure in all Member States (i.e. those without a public credit database or with no credit database at all, as in the case of Luxembourg).

Overall, option C2 was identified as the preferred option. It has the highest net present value among the options considered under objective C, as well as the highest benefit-to-cost ratio. This option is considered to pass the proportionality test and conform with both the 'digital by default' and 'do no significant harm' principles. Although this option also seems to be coherent with other EU policy and legislation, there is some uncertainty as to whether this option is fully coherence with measures already taken at a national level by some Member States. For example, establishing minimum standards for creditors on the types of (negative and positive) financial and economic information that can and cannot be used for creditworthiness assessment could run counter to well established laws and practices concerning the creditworthiness assessment in some Member States.

### 3.2.4. Objective D: Energy efficiency

For the fourth policy objective, concerning energy efficiency, five policy options were developed. These are the baseline (Option D0 – status quo) and four alternative combinations of policy measures (Options D1 to D4).

Policy option D1 introduces only one policy measure and, apart from maintaining the status quo, is the least ambitious of the policy options under this objective. Under this option, voluntary guidelines would be introduced for creditors and credit intermediaries, advising them to inform consumers about green mortgages. Although this measure is expected to enhance consumers' awareness about green mortgages, it would not incentivise their provision or uptake.

Policy option D2 goes slightly further than option D1. It introduces a legal obligation for creditors and credit intermediaries to inform consumers about green mortgages. It also introduces a requirement for creditors to offer mortgages for energy efficiency improvements at a lower rate. Together, these two measures are expected to create a higher demand and uptake of green mortgages. However, there is also a risk that any

costs incurred by industry may be passed on to consumers who cannot afford to conduct energy efficiency improvements.

Like policy option D2, under policy option D3, creditors and credit intermediaries would be legally obliged to inform consumers about green mortgages. However, unlike policy option D2, option D3 does not require creditors to offer mortgages for energy efficiency improvements at a lower rate, thus avoiding the possible risk of costs being passed to relatively poorer consumers.

Option D3 also requires the Member States to provide access to Energy Performance Certificates (EPCs). During the consultation, industry stakeholders explained that access to EPCs is crucial to enable the provision of green mortgages and so this measure is expected to be very effective in enabling lenders to offer green mortgages on new and recently renovated properties. There are some concerns however that only offering green mortgages for the most energy efficient properties might penalise poorer consumers who typically live in less energy efficient housing.

Option D3 also introduces a requirement for the Member States to report on industry best practice in relation to green mortgages, which is expected to help the Member States to identify best practice solutions that could be implemented at a national or local level.

Policy option D4 contains the same measures as option D3, but goes slightly further, requiring the term 'green mortgage' to be defined in EU legislation and creating a label for green mortgages offered with preferential terms and conditions. Although there is broad agreement that harmonised definitions are needed to reduce greenwashing and increase competition, industry has pointed to existing definitions of related terms (e.g. 'energy efficient mortgage') already in widespread use. Option D4 also requires creditors to be offered mortgages for energy efficiency improvements at a lower rate.

Overall, option D3 was identified as the preferred option. It has the highest benefit-to-cost ratio of all the options considered under objective D and passes the proportionality test. This option is also considered to be coherent both with other EU policy and legislation in related fields and with national measures taken by the Member States.

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