The Integration of European Mortgage Law: A Case Study on the Use of Multi-Level Governance Approaches in the Europeanization of Policy.

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Abstract

The Europeanization of policy previously dealt with at the national level can fulfil the purpose of the creation of solidarity and the strengthening of Europe as a political, legal and economic Union. Through the broadening of the ambit of European competence, Member States can be seen to be delegating an increasing range of policy areas to centrally created, or to centrally operated institutions of governance. Thus, as an increasing number of policy areas are Europeanized, harmonisation is effected. The creation of new models of governance, the characterisation of the European Union as a whole and the development of specific policy areas can all be understood through examination of the polity of groups of actors involved in policy development. Analysis of group dynamics, co-operations and constraints can be useful to understand policy development on a sectoral basis through the study of the behaviour of all actors within the network, rather than simply the governmental objectives, to shape our understanding of both how and why a policy is developed in a particular direction. This approach embraces the shift away from traditional forms of hierarchical government, towards the broader concept of governance. Thus, analysis of the interactions of groups involved in agenda-setting, policy development and implementation can provide an explanatory model within policy areas developed by way of either multilevel governance or new forms of governance.

The integration of EU mortgage law is currently being undertaken at a broad number of policy levels, identified by interested parties, the financial services industry, governmental bodies and consumer groups. Through this, insight can be gained as to the way that Europeanization of policy by way of new governance mechanisms can have broad impacts upon the way we understand and perceive broader social, political and legal concepts. This process of Europeanization can be seen as representative of trends within policy development within the EU. Whilst the trend towards Europeanization means a reduction in the regulatory autonomy of the Member States, the prevalence of new governance mechanisms ultimately results in a reduction of traditional, restrictive government.

Introduction

The integration of mortgage credit markets represents the flagship policy[1] development in the ongoing attempt to integrate retail financial services[2] within the EU. This process is representative of the Europeanization of policy that is becoming increasingly prevalent, as a result of the evolution of the single market.[3] The Single European Act made a significant contribution to this process, through the aim of "progressively establishing the internal market" through Article 18EC [4] and the establishment of Union competence to harmonise laws through Article 114 TFEU (ex Article 95EC) [5] The introduction of the European Monetary Union has further facilitated the process of integration. [6] Whilst this may generally be seen as an encroachment on national sovereignty and traditional understanding of democracy[7], it

is a necessary step to the facilitation of a single market for financial services.

Financial markets cannot be viewed as isolated national markets; the financial services industry operates internationally under the ambit of the operation of global capital markets. Integration can facilitate the operation of the market. This is underpinned by the requirement that any regulatory measure be addressed at the appropriate regulatory level in accordance with the principle of subsidiarity enshrined within Article 5(3)TEU, and by the procedure laid down in Protocol 2 TFEU. It follows that, where a sector operates across national, supranational and international spheres, then it is appropriate that any regulatory mechanism is capable of addressing the implications of the operation of markets across boundaries. The Commission's aim to integrate mortgage laws therefore appears to be a fundamental part of this facilitating the functioning of financial markets.

The Europeanization Paradox

The term "Europeanization" can be used to indicate several possible governance trends. These can emerge from changes in territorial boundaries to the European Union, through for example, the accession of new member states, the centralisation of policy at an EU institutional level or the broadening of the ambit of our understanding of traditional European Union competences. Although Olsen8 is therefore critical of the term as being potentially meaningless as an analytical device, due to the disparate contexts to which the term is applied, certain key themes and overarching concepts emerge from a typology of usage. Whether policy is "Europeanized" by a new Member State needing to fulfil the requirements of the existing treaty obligations on accession to the union, or by all Member States through the development of new laws, a central theme emerges of the strengthening of Europe as a political unity. This concept is linked to integration. The ideas of power struggles, of changes to modes of governance and the use of multi-levelled approaches are central to the concept of Europeanization. 9 The development of an integrated system of mortgage laws will exhibit themes consistent with Europeanization literature.

Integration can only occur if it is able to encompass the needs of the national markets, and to comply with international standards. This demonstrates the power struggles that occur both generally, where national laws must be changed in order to create an integrated system, and specifically, in the identification of how such an integrated system can be achieved, in identifying areas where regulation is required and the appropriate governance mechanism in order to achieve particular aims. This process of European integration is underpinned by the external constraints placed upon the system, by the need to comply with international rules.

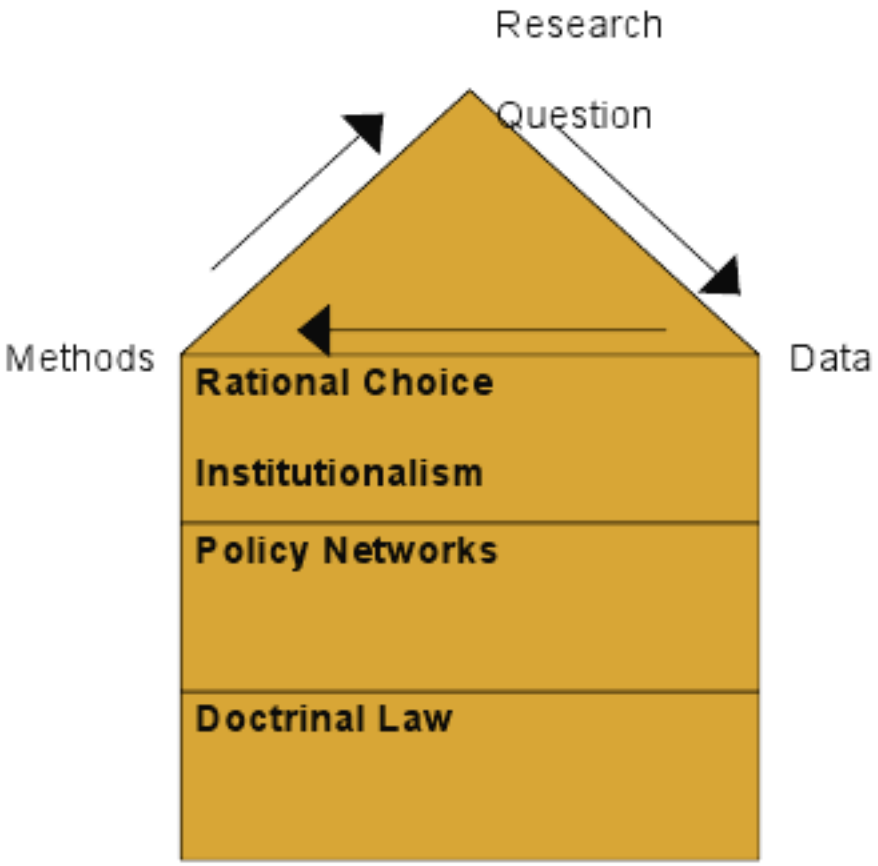
Mortgage law integration may bring long-term economic benefits to the EU.10 The Commission argue that integration is necessary for the economic development and competitiveness of the European financial services industry within an increasingly global banking sector. Integration of mortgage markets can therefore be viewed as a method by which the EU's Lisbon objectives on competitiveness can be achieved.11 It has been projected that integration could create an overall increase in GDP through the creation of demand for mortgage products.12 If such projections are accurate, the importance of integration of mortgage markets is not limited to the financial services

market but to the economy in general. Indeed the ramifications of the global "credit crunch" may be seen as fallout from American sub-prime lending. It therefore follows that the arguments for Europeanization within financial services appear compelling. Through vesting a degree of regulatory control of financial services in the centralised EU institutions, overall market strength, it is argued, will increase.

The central paradox is that "Europeanization" implies a reduction in the regulatory autonomy of Member States and, by extension, an increase in the amount of power vested in the central EU institutions. Member States prima facie diffuse powers to the European Institutions; the Commission retains the power of initiative and, if new legislation is created, this will be decided upon intimately by the Parliament and Council, in accordance with Article 95EC (now Article 114 TFEU). Nonetheless the way in which this power is exercised and the limits of the scope of regulation are decided on the advice of the stakeholders affected. This means that the operation of powers occurs in a far less autocratic manner than that which one would normally associate with traditional EU legislation. Rather, the approach taken by the EU institutions is consistent with the shift away from such government mechanisms. The move towards a multi-level governance approach within the arena of financial regulation marks a shift away from the purely political nature of the European Monetary Union (EMU) governance. 13 Throughout the development of EMU the emphasis was on the development of a political strategy, centred on co-operation between the governments of the Member States. Whereas a state-centric model was able to be applied in development of the policy surrounding EMU, the broadening scope of financial integration is now such that, owing to the number of stakeholders affected, and the international nature of banking models, a network approach is now a more practicable mode of governance.

As an increasing range of political issues previously dealt with at a national level are seen to fall within the scope of European regulation, an increasing number of actors participate in agenda-setting. This means that the power to create policy is not centralised through Europeanization. It is through the work of the network formed by the Commission, that integration objectives have been set. Although mortgage law is being Europeanized, this process does not represent an erosion of the role of nation states or an encroachment upon sovereignty. Power, although technically vested upwards in the institutions, is actually diffused throughout those affected.

The integration of EU mortgage law can provide a cognitive lens through which certain fundamental principles of European law and policy development can be better understood. Not only does it represent a sectoral study on Europeanization, but it also demonstrates facets of the relationship between law and policy, as well as shifts in modes of governance. Examination both of policy documents on the agenda setting process and of the existing legal disparities can provide insight into why the Commission considers integration necessary, and into how the process is being undertaken. Through the application of different methodologies, further insights can be gleaned. The study can therefore be conceptualised thus:



In order to answer the question "how are mortgage laws being integrated" it is necessary to ensure that the choice of data and methods are underpinned by a consistent methodological approach.

A combined doctrinal and socio-legal approach

The foundation level of understanding can be provided by analysis of legal doctrine. This is useful in identifying the current need for mortgage integration and an examination of the conditions which have contributed to the formation and objectives of the current policy group. A "black letter" approach of analysis will explain what the existing law is. It has been noted that differences exist between national laws in the way that collateral is provided, and in the form that the mortgage contract takes.14 Furthermore, the availability of certain types of products may differ due both to legal disparities and to cultural differences of the borrowing and lending practices within Member States.15 Indeed, the current lack of integration can be seen as tantamount to each Member State having a separate mortgage market 16, playing a comparatively minor role in the global marketplace. Such differences between Member States may create unfavourable conditions both for borrowers, through limited product availability within a given Member State, and lenders, through potential inability to access new markets.

Doctrinal analysis will be useful not only in identifying problems occurring due to disparities at a national level, but also in examining obligations at European level,

through analysis of the EU legislation. Mortgage transactions can be viewed both as services under Article 57 TFEU (ex Art. 50 EC) 17, given that they are of a "commercial character" and movements of capital under Article 63 TFEU (ex Art. 56 EC). 18 It can therefore be argued that there cannot be a complete internal market without internal frontiers under Article 26 TFEU (ex Art. 14 EC) where disparities in national laws create conditions that are unfavourable for the freedom to provide and receive services and for the free movement of capital. These conditions created by legal disparities can be seen as tantamount to internal frontiers preventing the complete liberalisation of fundamental freedoms. Doctrinal analysis is therefore useful as a method of addressing the need for harmonisation.

An entirely doctrinal approach would not, however, adequately achieve the purpose of studying the integration of laws. Integration theories can be seen not just as a lens through which the law can be examined, but also as a predictive tool for determining the likely success policy outcome or effectiveness, based upon the behaviour of the actors involved, the existence (or otherwise) of any shared values and the scope for further integration. Pure doctrinal law would not be suitable for answering such predictive questions, particularly where the policy development is still in relative infancy. A doctrinal approach is most suited to examination of traditional top-down modes of governance. However, where there is a need for contextualisation of the subject matter within the broader political influences which underpin legislative decision making, a doctrinal approach is insufficient. Such an approach is less suited to multi-level or new governance dominated policy areas, as the primary legal data does not provide a sufficiently broad picture as to why different governance modes or levels are required. The level at which measures will be adopted within EU mortgage policy making will be determined, not just on the basis of competence to issue directives and the principle of subsidiarity under Article 5 TEU, nor even on the basis of the best method of achieving a policy objective. It can be seen through the consultation process, and the advice that the Commission has taken from interested parties prior to the White Paper, 19 that the mode of governance will have been influenced by the interests of mortgage consumers and providers. Thus, the levels of governance within the policy area cannot be fully understood without recourse to the context in which the policy was formed.

Policy network approaches

A socio-legal approach can help to contextualise our understanding of the law20, providing a better framework to which a predictive model can be applied. Through examination of the current barriers to EU mortgage activity, to cross-border activity and the disparities in national laws, which create difficulties for mortgage lenders to break into new markets, one can begin to understand the interests of the parties and the way in which priorities have been determined within the integration agenda. Policy network analysis, intended as a conceptual tool, can be useful in predicting the likely outcomes of policy development when coupled with an understanding on the current legal environment within the field of EU mortgage laws. It therefore follows that both doctrinal and socio-legal methods are required in order to understand what is driving integration and why.

The origin of network theory can be traced to the 1970s with the development of

theory based upon the interaction of parties within policy co-ordination. Thus the term "community" is used to denote this interaction, as opposed to relating to geographic area. 21 Network analysis therefore has its origins in the concept of the policy community. Heclo and Wildavsky first adopted the community concept as an analogy for British bureaucracy, described as "village life". 22 The connotations of the usage are of closeness between the parties and a commonality of interest on behalf of the community. When applied to the development of European mortgage policy, the actors who are setting the policy agenda all have a broadly shared interest in the policy outcomes, insofar as they are all stakeholders. However, the conflicting priorities of the groups involved impacts upon the closeness of the network on specific areas of policy. Although all are working towards a more integrated market, consumer groups will wish to attain this through enhanced consumer protection, transparency of measures and adequate legal protection for consumers; industry representatives will be striving for greater access to markets, openness and co-operation in data sharing between Member States to facilitate market access.

Criticism has been made of policy network analysis on the basis of language. Peterson23 argues that the terminology used within policy networks analysis is imprecise to the point that it provides little value as a complete theory of integration. For example Rhodes24 suggests the term "Policy networks" should be used as a generic term encompassing a number of different types of groups responsible for the development of policy. Thus the concept of the policy network can be seen as a continuum, ranging from "issue networks", described by Richardson as "disorderly" 25 , through to the much more closely integrated concept of the "policy community".

Nonetheless, Börzel identifies four areas of understanding that have been developed by way of a policy network analysis within the broad concept of European governance:

1. Studies relating to policy-making on intergovernmental or supranational level - including the relationship between the Commission and interest groups.
2. Studies concerned with the strengthening or weakening of the nation state
3. The development of new forms of policy-making and architecture within the European Union.
4. The transformation of the national state and the Europeanization of policy development. 26

A study on the development of European mortgage law could potentially encompass all of these. The use of extensive consultation with stakeholders and the relationship between the Commission and those stakeholders can be seen as an important part of the agenda-setting process. This consultation process is taking place under the initiative of the Commission and consequently the relationship between interest groups and the Commission is central to the delineation of power to set the regulatory agenda.

Secondly, with the exception of the voluntary Code of Conduct for pre-contractual information (see below), there currently exists very little by way of implemented policy within this arena. Only more general provisions relating to the banking sector,

or to the fundamental freedoms such as capital and services, will impact upon mortgage regulation under the existing regime. It follows that integration could be seen as a widening of EU competence, affecting the relative strength of the nation state. Although it is argued that it would be simplistic to view mortgage law Europeanization as an encroachment of national sovereignty, it is still relevant to address the subject in the context of the impact upon the regulatory strength of Member States.

Thirdly, a multi-level approach to policy is consistent with the development of new forms of architecture, through the use of both binding and non-binding legal mechanisms to attain policy objectives. Due to the wide range of objectives which can be achieved through integration and the diverse range of actors involved, the Commission has identified the best level for achieving different mortgage market objectives, through a wide variety of governance mechanisms:

- present new legislation
- enforce existing EU legislation;
- encourage self-regulation;
- publish a Recommendation;
- issue guidelines;
- develop a 'scoreboard';

- do nothing

The impact assessment identifies certain policy areas where the most suitable option will be legislation. This includes the provision of pre-contractual information to consumers, previously regulated by way of a Code of Conduct (see below). Although this policy area will therefore represent a move away from a self-regulatory system, there are other areas where self-regulation is considered the appropriate level for regulation, such as the maintenance of credit registers. Non-binding methods have also been identified as appropriate in certain areas. In order to regulate forced sales procedure and land registration, both Recommendations and scoreboards have been considered appropriate.27 The use of scoreboards is particularly interesting as a new governance approach consistent with the Open Method of Co-ordination, through the setting of benchmarks to encourage best practice.

Lastly, the integration of mortgage law can be seen as a study on the Europeanization of policy development, as regulation previously addressed at national and international levels are seen to fall within European Union competence.

It is clear that an examination of the policy network can provide a useful analytical tool in understanding the aims and methods of integrating mortgage laws. However, due to the limitations of policy network analysis as a methodological approach, this alone can only give a limited insight when addressing how the Europeanization of mortgage laws has come about through new forms of architecture. It is useful only in determining that the law is being developed through means other than the traditional, top-down model of State actor and European Institution driven law. It fails to

adequately address why this is.

Actor-based approaches

By providing a 'new institutional' perspective on policy networks, further theoretical insight can be gained as to how policy networks influence the development of policy and ultimately of law. Rational choice institutionalism, based upon the "principal-agent theory", examines the difficulties of principals (governments) in controlling the activities of their agents (the institutions). Thus, the operation of rules can be seen to determine the balance of power between participants, the actions taken and the outcomes determined. 28 The concept can also be extended to include the constraints of internal market law and its use as a resource. 29 By applying an institutionalist framework to the actions of the policy network, the legal constraints acting upon the participants can be seen as an institution. 30 This approach is therefore useful for providing greater analytical insight into the operation of policy networks. 31 Any policy must be consistent with the already existing legal framework of the Capital Requirements Directive 32 and the Data Protection Directive. 33 The Capital Requirements Directive is reflective of the Basel II rules on capital standards agreed at G-10, demonstrating the influence of international standards within EU policy development. This body of international rules can therefore be seen as an external constraint operating upon the decisions of the network. Although a broad range of policy options is presented, the network may only operate within pre-existing constraints which can be viewed as part of the "rules of the game". Policy is seen to manifest across different governance tiers and different regulatory aspects of the central theme of mortgage law integration. Nonetheless it may only do so within the confines of existing internal market law and under the umbrella of international regulatory requirements. By examining the way in which policy is developed through a new institutionalist methodology, theoretical insight can be gained not only as to *how* the network develops policy but also why. This will provide a more effective predictive tool as to the scope for further integration of law, future actions of the network and the likelihood of success of any policy initiative.

Pre-contractual information: a case study on attempted harmonisation

An attempt has been made to harmonise the pre-contractual information provided to consumers across Member States, prior to their entering into a mortgage contract. The development of the "European Agreement on a Voluntary Code of Conduct for pre-contractual information on home loans" (hereinafter "the Code") can be viewed as a case study on the Europeanization of mortgage law through the actor-based approaches to regulation outlined above. It is based upon a pre-existing voluntary code devised by the Council of Mortgage Lenders within the UK which was considerably well developed within the area of consumer information. Brokered by the Commission, through consultation with European Credit Sector Associations and Consumer Organisations, implementation of harmonising measures took the form of a Recommendation34 issued to Member States to urge compliance for the provision of transparent and comparable information to be provided across the Union. 35 This approach to harmonisation acknowledges the importance of consumer information to facilitate cross-border activity, forming an important part of the single market review. 36 Empowerment of consumers has since been identified as a primary aim of

integration37 through access to harmonised information, thereby increasing consumer confidence and consumer protection.

The Recommendation reiterated the significance of the home loan as the most significant financial transaction typically entered into by the consumer38, thus emphasising the need for adequate information to encourage activity. It was argued that there was a need for harmonising rules for two types of information: general information provided to all consumers; and personalised information provided to the individual, in the form of a European Standardised Information Sheet.

The choice of a Recommendation to bring about harmonisation in this area is representative of current shifts towards softer law approaches in EU governance. Recommendations have no binding force upon those to whom they are addressed under Article 288 TFEU (ex Art. 249 TEC). It has fallen upon individual lenders to bring about any necessary changes within their lending practices and has fallen to regulatory bodies within Member States to ensure compliance and consistency of implementation. Within the United Kingdom, the prevailing assumption, given the origins of the Code, was that all lenders currently complying with domestic policy would also therefore automatically be in compliance with the European Code. This was based upon the assumption that the Financial Service Authority rules within the UK encompass all elements of the European Code 39 and that no further action was therefore necessary to implement the rules. This, however, is not true; there is an area of the UK regulatory rules that is not consistent with the Code. UK lenders are not obliged to provide consumers with an amortisation table, (as required by paragraph 14 of Annex 2 of the Code). The UK Financial Service Authority and Council of Mortgage Lenders considered that this was not a necessary feature of the provision of information 40 as UK consumers would not necessarily understand or rely upon such a table. This nonetheless demonstrates the potential flaw in regulation by way of voluntary code where the aim is to achieve comparable results across the EU. Even within the Member State whose pre-existing regulatory structure formed the basis of the Code there is potential for inconsistencies within the types of information provided and the manner in which it is presented.

Further difficulties have been encountered across other Member States, resulting in highly disparate implementation and thereby failing to fulfil the aim of transparent and comparable information across the internal market. “Mystery-shopping” spot checks, used by the Institute for Financial Services in order to determine whether there has been proper implementation and fulfilment of the Code, indicate a number of omissions.41 These included a lack of general information and information about complaints procedures as well as general misunderstanding of the Code on the part of financial service providers. Most notably, as the Code does not provide a definition of the term “pre-contractual”, there were inconsistencies across the EU as to when both general information and the ESIS are provided. As a result, in some circumstances consumers were only being provided this information immediately prior to entering into a formal contractual agreement, if at all. 42 This highlights the need for stricter regulation, as this misinterpretation of the Code has the potential to completely negate the purpose of providing such information in a standardised manner, which is to empower consumers to make informed decisions. Industry representatives were keen to attribute poor implementation to a number of factors, including technical difficulties relating to staff training due to the timing of the report, shortly after the

implementation (i.e. teething troubles). [^42] However, they also blamed implementation problems on the voluntary nature of the Code. Whereas binding legislation would supersede Member State rules, the Recommendation allows for the Code to be integrated within the existing regulatory schemes of Member States. As a result this can lead to problems of "coherence". Whereas with binding legislation contradictory measures of domestic law would be disapplied, problems of sovereignty and the relative importance of national and EU measures arise.

Furthermore, due to the voluntary nature of the Code there have been highlighted instances of general non-compliance. In 2004, the Forum Group on Mortgage Credit conducted a second report 43 on implementation. This recognised the difficulties arising out of the currently voluntary code, described as "by large ineffective as long as it has no enforcement capacity". 44 Furthermore, the reporting technique used to monitor implementation can be criticised as potentially inaccurate. Information was gained by surveying national mortgage councils or by way of information provided by the financial institutions. This is unlikely to reflect the proper implementation of the Code to any satisfactory standard, due to the reasons outlined in the mystery shopping report, concerning misimplementation and interpretation, as well as omissions in the information provided. It therefore follows that the one area of mortgage regulation that has currently been harmonised potentially fails in the objectives of protecting the consumer and standardising the provision of information. This highlights not only the importance of further work in this area on the part of the EU to meet the objectives of consumer protection but also the need for all measures taken to be implemented at the correct level of governance so that the aims can be achieved. The impact assessment of the white paper on mortgage credit has since determined that pre-contractual information is still restrictive of cross-border mortgage activity, impacts upon consumer confidence and restricts consumer mobility. It has been identified as an area of policy where the most effective option will likely be legislation. 45 A study has now been undertaken to decide how to revise the ESIS in order to improve consumer information.46

This is demonstrative of the way that Europeanization is not simply a transferral of powers to the centralised European institutions. Legislation can be seen as being the appropriate level at which to regulate, only after self-regulatory mechanisms failed to fulfil the purpose of harmonisation. Through a doctrinal lens we could see that disparities exist across different Member States in the way in which information is provided to the consumer. The policy network attempted to harmonised rules through the use of non-binding mechanisms. An institutional perspective demonstrates that the aims of the actors involved in the group and the limits of European competence will all impact upon the ultimate policy outcome. Whilst consumer protection (Article 2C(2)(f) TFEU) and the functioning of the internal market (Article 2C(2)(a) TFEU) can be seen to fall within shared competence, the manner in which this competence is exercised is not autocratic. It is only after self-regulatory "soft law" mechanisms are deemed inadequate to meet the regulatory needs, by the same interest groups originally involved in there development, that "hard law" options are considered the most appropriate action.

Conclusion

EU internal market law can be seen as a starting point within the integration process. Disparities between national laws have potentially detrimental effects upon the operation of the Treaty's "fundamental freedoms". Thus, it is the objective of removing legal barriers that has prompted the Commission to act as a catalyst to this process. Law may ultimately be both the start and end point in this process, as a motivating factor for integration and as part of the range of outcomes, including enforcement of existing legislation and the potential scope for new legislation. The study is demonstrative of the way that European policy development occurs. It would be simplistic to view Europeanization as simply a shift in sovereignty or control of policy areas from the national to supranational level. Rather, it must be viewed within the context of the different governance levels at which the policy may operate. When developing an agenda for a policy area with national and international implications, supranational policy cohesion is a logical step in the strengthening of mortgage markets. As the liberalisation of mortgage availability can already be seen as falling within the ambit of the Treaty's fundamental freedoms, the Europeanization of policy in this area should not be seen as an encroachment on the power of Member States. Instead it can be seen as a diffusion of power throughout the bodies most closely affected. The integration of pre-contractual information through the development of the Code demonstrates the extent to which stakeholders are responsible for both development and implementation of rules. It further shows that Europeanization does not result in the use of traditional top-down EU governance on an arbitrary basis. The extent to which consultation has occurred, both in development of the Code and latterly in discussion of potential amendments to the way this information is provided is indicative of the protection given by the principle of subsidiarity.

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