



ATTORNEY GENERAL FOR CIVIL AFFAIRS

To the EFTA Court

OSLO, 17 January 2023

Written Observations by the Kingdom of Norway

represented by Sverre Runde, associate at the Office of the Attorney General for Civil Affairs, and Ingeborg Collett, advisor at the Ministry of Foreign Affairs, acting as agents, submitted pursuant to the third paragraph of Article 20 of the Statute and Article 90 of the Rules of Procedure of the EFTA Court, in

Case E-13/22 - Birgir Þór Gylfason and Jórunn S. Gröndal v Landsbankinn hf.

in which Héraðsdómur Reykjavíkur (Reykjavik District Court) has requested an advisory opinion pursuant to Article 34 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (SCA) on the interpretation of Article 24 of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (hereinafter the "Mortgage Credit Directive" or the "MCD") and Article 10 nr. 2 (f) of Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (hereinafter the "Consumer Credit Directive" or the "CCD").

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1 INTRODUCTION

- (1) Reykjavik District Court (hereinafter "the referring court") has requested the EFTA Court to give an advisory opinion in a dispute concerning a non-indexed mortgage agreement with variable interest rate entered into between two consumers and the Icelandic bank "Landsbankinn hf". In short, the disputed term in the mortgage agreement states that the bank can unilaterally adjust the interest rate, taking into account, amongst other things, the Central Bank of Iceland's interest rate, interest rates in the market and other conditions for

financing available to the creditor. The complainants argue that the term does not comply with Article 24 of the Mortgage Credit Directive and Article 10 (2) (f) of the Consumer Credit Directive.

- (2) For further details on the factual background of the case, the Norwegian Government refers to page 1–3 of the request for an advisory opinion.
- (3) The referring court has submitted the following question to the EFTA Court:

Is it compatible with Directive 2014/17/EU, in particular, Article 24 of the Directive, and, as appropriate, Article 10(2)(f) of Directive 2008/48/EC (cf. recital 19 of the Preamble to Directive 2014/17/EU), that the terms of a consumer property mortgage, in which the interest rate is variable, state that adjustments of the interest rate are to take account of, amongst other things, the Central Bank of Iceland's interest rate, interest rates on the market and other terms of finance available to the creditor?

2 CONSIDERATION OF THE QUESTION REFERRED

2.1 Preliminary remarks

- (4) The referring court essentially asks whether the aforementioned provisions prohibit a term in a mortgage agreement between an Icelandic bank and a consumer, which allows the bank to unilaterally adjust the borrowing rate considering, amongst other things, the Central bank of Iceland's interest rate, interest rates on the market and other terms of financing available to creditors.
- (5) The Norwegian Government firstly remarks that the Consumer Credit Directive applies to credit agreements for consumers. It does not, however, apply to mortgages. In Article 2 (2) (a), it is clearly stated that the CCD shall not apply to the following:

credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on immovable property or secured by a right related to immovable property;

- (6) Contrary to this, the Mortgage Credit Directive Article 3 (1) (a) states that the directive shall apply to

credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on residential immovable property or secured by a right related to residential immovable property;

- (7) The CCD and MCD thus regulate separate types of loan agreements and do not overlap with regard to the question that the EFTA Court is asked to provide guidance on in the present case. The Norwegian Government reiterates that although recital 19 of the preamble to the MCD sets out that the definitions and key concepts are sought to be the same in both directives, this does not entail that specific provisions in the CCD apply outside of the scope

of that directive. The Norwegian Government holds that the specification requirements relating to the borrowing rate and adjustments thereof which are set out in Article 10 (2) (f) of the CCD are neither "*definitions*" nor "*key concepts used in standard information to designate the financial characteristics of the credit*" which shall apply to the MCD, cf. recital 19 to the preamble of the MCD. The Norwegian Government therefore submits that the requirements set out in Article 10 (2) (f) of the Consumer Credit Directive, as such, do not apply to the mortgage agreement in the present case.

- (8) The EFTA court is nonetheless competent to provide an interpretation of the provision if Icelandic domestic legislation, in its internal regulation of mortgage agreements, have adopted the same or similar solutions as those adopted in the CCD Article 10 (2) (f), see the EFTA Court's judgement in Case E-25/13 *Engilbertsson* paragraph 54 with further references.
- (9) It is somewhat unclear in the request for an advisory opinion whether this is the case in Iceland. According to page 15 of the request for an advisory opinion, the Icelandic Consumer Property Mortgage Act Article 34 (1) second sentence, requires that a mortgage agreement shall "*state the conditions and procedure for adjustment of the interest rate*" if the parties have agreed that the decision to adjust the borrowing rate is not based on a reference value, index or a reference interest rate. According to the referring court, it follows from the provision's preparatory works that the wording is based on the Icelandic Consumer Credit Act Article 7 (4) (f), which constituted the transposition into Icelandic law of the CCD. This entails that a similar solution as that provided in the CCD Article 10 (2) (f) has been adopted into Icelandic domestic legislation with regard to terms of a consumer property mortgage.
- (10) However, similarly to the CCD Article 10 (2) (f), the Icelandic provision invoked by the complainants in the present case only requires that the consumer is given information about the conditions and procedures for changing the borrowing rate, albeit in a "clear and concise manner", cf. the first sentence of the CCD Article 10 (2). Neither provision sets out any restrictions on *which* conditions or procedures that can be used by the bank to adjust the borrowing rate. It is evident that the consumer in the present case has been given such information, i.e. that adjustments of the borrowing rate is to be decided by the bank, with account to, amongst other things, the Central Bank of Iceland's interest rate, interest rates on the market and other financing terms available to the bank.
- (11) Regardless of whether the CCD Article 10 (2) (f) is applicable, the Norwegian Government holds that the provision does not restrict the use of terms in a property mortgage agreement which entail that changes in the borrowing rate can be decided by the creditor with reference to other factors than indexes and reference rates, provided that such information is provided to the consumer in a satisfactory manner.
- (12) The Norwegian Government therefore submits that the Consumer Credit Directive Article 10 (2) (f) does not prevent Member States from allowing the use in consumer mortgage agreements of such terms as the term in question in the present case.

- (13) Secondly, the Norwegian Government remarks that the referring court has asked for an interpretation of the MCD Article 24, which sets out certain requirements of availability and transparency applicable to any indexes or reference rates based on which the parties have agreed to calculate the borrowing rate. However, the referring court's reference to the agreement between the complainants and the defendant shows that the parties have *not* agreed to use an index or reference to calculate the borrowing rate. Instead, the parties have agreed that "*Landsbankinn may, at any time during the loan period, raise or lower the (...) interest rate in accordance with Landsbankinn's interest-rate decisions at any given time*". Thus, the parties have agreed that changes in the borrowing rate shall depend on an internal decision from the bank, and not necessarily correlate with changes in an index or an agreed reference rate.
- (14) Consequently, the Norwegian Government fails to see the relevance of the requirements in MCD Article 24 when reviewing the compliance with EEA law of the mortgage term in question.
- (15) In the following, the Norwegian Government will elaborate on its assessment of MCD Article 24 in Section 2.2. Section 2.3 will provide a brief summary of other requirements that apply to mortgages where the parties have agreed to let the bank change the borrowing rate unilaterally. Section 3 sets out the Norwegian Government's position with regard to the question referred to the EFTA Court in the present case.

2.2 Assessment of the Mortgage Credit Directive Article 24

- (16) The Mortgage Credit Directive applies to all loans made to consumers for the purpose of buying residential immovable property. The MCD aims to enable consumers to understand available mortgage products, their different nature and the financial obligations that the consumer will commit to if entering into a mortgage agreement. Sufficient information to the consumer is important, considering that mortgage agreements often stipulate that its terms could change during the term of the agreement, e.g. allowing the creditor to raise or lower the interest rate, fees or other credit costs unilaterally.
- (17) The Norwegian Government acknowledges that there are considerable variations within the Member States with regard to the specificities of the domestic financial credit market and what types of loan agreements that are common. The MCD reflects these differences and allows the parties to a loan agreement to agree on either a fixed interest rate, a variable interest rate or a combination of these. A fixed interest rate will stay the same either for the entire loan period or during an agreed term of the loan period. A variable interest rate, on the other hand, is one that changes periodically, typically reflecting the economic or financial market conditions.
- (18) Mortgages that carry variable rates can be based on a pre-set margin and a major mortgage index such as the interbank offered rates (IBORs), e.g. EURIBOR. If so, the interest rate will fluctuate periodically based on the performance of the specific benchmark, so that the borrower's cost of the loan increases if the reference rate is adjusted upwards, and decreases if the reference rate is reduced. Such reference rates, also known as interest rate benchmarks

or just benchmark rates, provide a useful and objective standard for variable rate credits that neither party can influence, thus ensuring that the value of the contract remains impartial and indisputable. This, however, presupposes that the benchmark rate is calculated in a transparent manner and that the rates are easily and publicly accessible. Historically, certain market developments have undermined the reliability of some existing benchmark rates, causing the EU legislator to launch a reform to harmonize the requirements of indexes and reference rates used in the financial markets (see Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016, which amended both the MCD and CCD).

- (19) In other variable rate mortgage agreements, it may be agreed that it is up to the bank to set the borrowing rate based on an internal assessment, cf. the preamble to Regulation (EU) 2016/1011 recital 20: *"A borrowing rate provided by a creditor is either set by an internal decision or calculated as a spread or mark-up over an index (e.g. EURIBOR)."* Allowing the bank to adjust the interest rate based on internal decisions entails less predictability for the consumer. However, a bank's internal decisions will often reflect the general fluctuations in market rates, e.g. with a view to benchmark rates. Provided that the competition between banks is sustainable, the banks will compete on offering the lowest variable rate at any given time, giving consumers an opportunity to switch to the bank with the best interest rate offer.
- (20) A third possibility is to allow the interest rate to be adjusted on the basis of the sale of underlying bonds or other long-term financing instruments, see e.g. the MCD Article 14 (6) paragraph five.
- (21) The Norwegian Government emphasizes that no provision in the MCD prevent Member States from allowing banks and consumers to choose between these variations of terms within the variable rate credits. This context is important when interpreting Article 24, which in the Norwegian Government's opinion, only applies to mortgage terms where it is agreed that changes in the borrowing rate shall be correlated to changes in an index or reference rate.
- (22) The wording of MCD Article 24 reads:

Where the credit agreement is a variable rate credit, Member States shall ensure that:

(a) any indexes or reference rates used to calculate the borrowing rate are clear, accessible, objective and verifiable by the parties to the credit agreement and the competent authorities; and

(b) historical records of indexes for calculating the borrowing rates are maintained either by the providers of these indexes or the creditors.

- (23) Neither "index" nor "reference rate" is defined in the MCD. However, as explained above, indexes and reference rates are well-known concepts within the financial sector. In Directive 2015/2366/EU Article 4 (28), a "reference interest rate" is defined as the *"interest rate which is used as the basis for calculating any interest to be applied and which comes from a publicly available source which can be verified by both parties to a payment service contract"*. In

Regulation (EU) 2016/1011 Article 3 (1) paragraph 22, an “interest rate benchmark” is defined as a benchmark “*determined on the basis of the rate at which banks may lend to, or borrow from, other banks, or agents other than banks, in the money market.*” Thus, a reference rate or index is an external, publicly available benchmark that the parties to an individual contract do not control.

(24) The Norwegian Government assumes that, in lack of other definitions, the terms “index” and “reference rate” in MCD Article 24 must be understood in accordance with how they are commonly defined within the finance and credit sector and applicable EU-legislation, meaning that if the parties choose to correlate changes in the borrowing rate with changes in an index or reference rate, it is required that those benchmarks are clear, accessible, objective and verifiable etc.

(25) Article 24 does not, however, prevent the parties from agreeing that changes to the borrowing rate can be decided internally by the creditor, based on other factors than indexes or reference rates, such as e.g. financial costs, operating costs or general trends in the market. The wording “*any indexes or reference rates used to calculate the borrowing rate*” (our emphasis) implies that the requirements of clarity and accessibility apply to any indexes or reference rates used to calculate the borrowing rate, but only to the extent such indexes or reference rates are in fact used to calculate the borrowing rate. The provision does not itself state that indexes or reference rates must be used to calculate the borrowing rate on a variable rate mortgage. The Government recalls that no other provision in the MCD state that variable rate credits must be connected to an index or reference rate. If the legislator intended the directive to restrict the banks' right to decide interest rates internally, such intention should have been reflected in clearer language.

(26) In this regard, the Norwegian Government reiterates that Article 24 of the MCD was not a part of the Commission's original proposal but was amended during considerations before the Parliament, without any further explanation in the Report from the plenary sitting where the wording was first introduced.¹ The European Economic and Social Committee (the “EESC”) had previously suggested that “*certain provisions be clarified or enlarged upon in order to enhance consumer information on variable rates*”, further stating that

*usurious interest rates should be banned, that lending rates for the main residence should be capped, and that changes in interest rates should be based only on objective, reliable and public indices that are external to the lender.*²

(27) This proposal from the EESC, i.e. that changes in interest rate should be based “only” on such indexes, was not implemented in the wording of Article 24 or any other provisions in the MCD. Thus, it is implausible that Article 24 was intended to prohibit this mechanism for adjusting interest rates in mortgage agreements. Instead, recital 67 of the preamble to the MCD sets out that “*Member States should be able to maintain or introduce restrictions or*

¹ Report on the proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property (COM(2011)0142 – C7-0085/2011 – 2011/0062(COD)) page 78.

² Opinion of the European Economic and Social Committee (COM(2011) 142 – 2011/0062 (COD) page 2.

prohibitions on unilateral changes to the borrowing rate by the creditor". For instance, it is suggested in recital 43 of the preamble that the Member States can set other requirements for what must appear in the European Standardised Information Sheet (ESIS) regarding "*the type of borrowing rate*" in order to take into account "*the specificities of the national products and market*". The MCD thus clearly presupposes that it is up to the Member States to introduce restrictions on the banks' right to adopt terms that allow for internal decisions on changes in the borrowing rate.

- (28) The Government further recalls that MCD Article 27, concerning changes in the borrowing rate, clearly recognizes that the borrowing rate could be changed with reference to other factors than indexes or reference rates. Article 27 (1) reads:

Member States shall ensure that the creditor informs the consumer of any change in the borrowing rate, on paper or another durable medium, before the change takes effect. The information shall at least state the amount of the payments to be made after the new borrowing rate takes effect and, in cases where the number or frequency of the payments changes, particulars thereof.

- (29) The provision does not require any justification from the bank for the adjustment. However, the bank must inform the consumer about the new borrowing rate before each adjustment, except "*where the change in the borrowing rate is correlated with a change in a reference rate*", see Article 27 (2). If the change is correlated with a change in a reference rate, and information about the reference rate is publicly available and communicated to the consumer personally, banks are allowed to inform the consumer periodically of changes in the borrowing rate. If the change in the borrowing rate is not correlated with a change in the applicable reference rate, however, periodic information is only accepted where this was allowed under national law before 20 March 2014, see Article 27 (3). This shows that MCD Article 27 clearly assumes that banks can request changes to the borrowing interest rate based on other factors than changes in a correlated index or reference rate, provided that the parties have agreed to use this mechanism.
- (30) On this basis, the Norwegian Government submits that Article 24 of the MCD does not prohibit a term in a consumer property mortgage which allows the bank to unilaterally adjust the interest rate based on an internal decision which is based on other factors than indexes or reference rates.
- (31) The Government further holds that the disputed term is compatible with the other provisions in the MCD, as elaborated on in Section 2.3 below.

2.3 General requirements that apply to consumer mortgages with variable interest rates

- (32) To protect consumers against unfair credit terms and to enable consumers to have full knowledge of the terms of mortgage agreements entered into, the MCD generally requires that the creditors give adequate information and guidance to the consumer. The MCD establishes guidelines both on marketing and advertising and provides obligations on the

creditors regarding the provision of general information as well as requirements regarding the credit agreement and total cost of credit. Whether these provisions are satisfied in the present case is up to the referring court to decide, cf. the EFTA Court's judgement in Case E-27/13 *Gunnarsson* paragraph 94. In the following, the Norwegian Government will nevertheless highlight some of the general requirements that apply to the mortgage term in question.

- (33) In general, Article 14 (1) of the MCD requires that creditors provide consumers with *"the personalised information needed to compare the credits available on the market, assess their implications and make an informed decision on whether to conclude a credit agreement"*. Such information must additionally be adequately explained to the consumer, cf. Article 16.
- (34) Article 11 of the MCD describes the required standard information that must be included in the banks' advertising. Information about the borrowing rate, whether it is fixed or variable, must be specified in a *"clear, concise and prominent way"*, cf. Article 11 (2) (c). An example that specifies this information must be included, see Article 11 (3). Additionally, Article 13 (1) (e) states that the bank must provide a *"short description of the characteristics of a fixed and variable rate, including related implications for the consumer"*.
- (35) Further, it follows from the MCD Article 11 (2) (e) that information about the annual percentage rate of charge (APRC) must be specified. According to Article 17 (1), the APRC shall be calculated in accordance with the mathematical formula set out in Annex I. If the borrowing rate is variable, the consumer shall receive information about the possible consequences of the variations and the annual costs that illustrate the possible risks associated with a significant increase in the interest rate, see Article 17 (6). Such information should at least be provided through ESIS, and if an index or reference rate is not used to calculate the variable rate, an example that illustrates the highest borrowing rate the bank has offered in the last 20 years should be included, cf. Section 4 (2) of the instructions to complete the ESIS attached as Annex II to the MCD. This information contributes to the transparency of the market, as it enables the consumer to compare offers of credit.
- (36) In addition to the above-mentioned provisions regarding the duty to give sufficient information to the consumer, the MCD also requires that the Member States ensure that the consumer is able to make early repayment under the mortgage agreement prior to the expiry of that agreement, cf. Article 25. As explained in Section 2.2 above, variable rates that allow the bank to decide changes in the borrowing rate unilaterally rely on the possibility for the consumer to make early repayment under the agreement and move the mortgage to another bank. According to Article 25 (5), the Member States may only provide that withdrawal is subject to a *"legitimate interest"* if the borrowing rate is fixed. If the rate is variable, the Member States shall ensure that the consumer has a right to withdraw without explanation. As long as the competition on the mortgage market is sustainable, this mechanism will give the consumer an opportunity to find the lowest possible interest rate available in the market.
- (37) The Norwegian Government holds that these provisions, which contribute to the transparency of the market and enable the consumer to compare offers of credit, provide

the consumer with sufficient information to make an informed decision also with regards to the requirements of Directive 93/13/EEC, provided that the creditor explicitly describes the term in question in the agreement. The Government reiterates, however, that it is for the referring court to assess whether the term at issue is unfair, including whether the terms of the agreement were described to the consumer in a satisfactory manner, cf. the EFTA Court's judgement in case E-25/13 *Engilbertsson* paragraph 91.

- (38) Considering the above, the Norwegian Government submits that the MCD does not prevent the Member States from allowing the parties to agree that the borrowing rate can be changed unilaterally, provided that the terms of the agreement regarding such changes are described to the consumer in a satisfactory manner.
- (39) Should the Court reach the opposite conclusion with respect to the interpretation of the MCD, i.e. so that the Member States must ensure that mortgages correlate the borrowing rate to indexes or reference rates, this would entail less flexibility for the banks when offering borrowing rates. This could result in the banks stipulating a higher margin on mortgages. It could also steer the competition between banks towards the act of granting the loan rather than continuously offering competitive interest rates. This in turn may increase mortgage costs for consumers. Should the MCD have been intended to restrict the banks' ability to offer variable rates not based on indexes or reference rates, it would require a thorough investigation and analysis of potential consequences for the credit market and consumer rights before implementation. Seeing as neither the preparatory works, provisions in the MCD nor any existing case law have conducted such an analysis, the Norwegian Government submits that the MCD cannot be interpreted as including such a restriction.

3 ANSWER TO THE QUESTION REFERRED

- (40) On this basis, the Norwegian Government respectfully submits that the question referred to the EFTA Court is answered as follows:

Directive 2014/17/EU Article 24 and Directive 2008/48/EF Article 10 (2) (f) do not restrict the use of terms in a consumer property mortgage agreement which entail that changes in the borrowing rate can be decided by the creditor with reference to other factors than indexes and reference rates, provided that the terms of the agreement regarding such changes are described to the consumer in a satisfactory manner.

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