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The Integration of the Mortgage Markets in Europe : (Part I)

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THE INTEGRATION OF THE MORTGAGE MARKETS IN EUROPE[1] (PART 1)[2]

INTRODUCTION

This contribution[3] seeks to depict the Eurohypothec and the Eurotrust as two instruments to achieve an integration of the mortgage market in Europe from the perspective of the EU Commission Green Paper of 19-7-2005[4] and the EU Commission White Paper of 18-12-2007[5] on mortgage credit in the EU, while comparing Eurohypothec's model grade of flexibility and usefulness to the ones of current national mortgage legislations, providing a deeper insight of the Spanish mortgage reform 2007.

It is intended to show that there is a need for the integration of the mortgage market in Europe as this would bring advantages in form of several trans-national mortgage operations that currently are difficult or impossible to structure in many EU countries (which implies disadvantages to European lenders and borrowers), following the EU Comission's Green and White Papers. The Eurohypothec is shown as an optimised instrument to achieve this, especially in a financial crisis context, in which trust, certainty (by law) and legal transparency are more appreciated and even more needed than ever. Some examples of trans-national operations with mortgages are provided in which it is evidenced that a common mortgage instrument would allow many EU countries to engage in those operations in an optimised way.

The topic of the Eurohypothec is older than 60 years now, but it is only recently that it has again assumed prominence on the European Commission's agenda. This recent history of the Eurohypothec began with the release of the Green Paper on the Mortgage Market 2005, which dedicated a whole point of discussion to the idea of the Eurohypothec, quoting a piece of research that contains the model of Eurohypothec that was created by a group of researchers after several years of studying the matter: the Basic Guidelines for a Eurohypothec 2005 (Drewicz-Tulodziecka, 2005). In December 2007, the EC White Paper, which deals with the steps required to advance the integration of EU mortgage markets, was released.

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[1] This contribution falls within the Research Project "Catalan, English and Irish experiences in relation to access to a dwelling" (Res. 21.12.2010; 2010 PBR 00052).

[2] The second part of this article will be published in SJLS no. 4. It will refer, inter alia, to the Eurohypothec and the Eurotrust and the Spanish mortgage reforms of 2007.

[3] This piece of research has its origin in a Working Paper published by the *Zentrum für Europäische Rechtspolitik* at Universität Bremen (ZERP-Diskussionspapier 2/2008), whose Director is Prof. Christoph Schmid.

[4] COM/2005/0327 final.

[5] COM(2007) 807 final.

However, no development has been undertaken since then at EU level[6]. Neither generalist pan-European research projects[7] have paid much attention to the possibility of creating a true European mortgage market, despite its undoubted importance at legal, economical and financial levels.

I. THE EUROHYPOTHEC

1. THE EUROHYPOTHEC AS AN IDEAL MODEL OF A PANEUROPEAN REAL CHARGE

When Eurohypothec researchers tried to achieve a "common mortgage" model for Europe, they searched for an ideal model, in the sense that it was not necessarily a real model, but one which would be as much **useful** as possible for purposes of the main goal: creating a Paneuropean mortgage tool that facilitates the creation of an integrated Paneuropean mortgage market.

Therefore, the currently presented model (the model in the Basic Guidelines 2005[8]) should, in any case, prove to be **more beneficial** than that offered by the current model of transnational mortgage funding (at least 27 types of mortgage systems ruled by the *lex rei sitae*). The typical transnational situation that the Eurohypothec seeks to address refers to the case where the lender is in a different EU country other than the piece of land which is to be used as security for the loan/loans to be granted to a borrower, irrespective of where he is.

This "more beneficial" idea should relate both to the lender and borrower:

a) Lender: the Eurohypothec should be able to facilitate the development of a legal framework for optimal Paneuropean mortgage lending and mortgage funding (active and passive operations of the mortgage market).
b) Borrower: Greater freedom in choosing (and changing) the lender, due to increased competition. According to the 2007 Report of Mercer Oliver & Wyman for the European Mortgage Federation (EMF, Mercer Oliver & Wyman, 2007), a link exists between the decrease in costs of a mortgage and an increase in the concurrence among credit institutions in several European countries in recent years, as illustrated in Germany, Ireland, Greece, France and Belgium. The White Paper 2007 supports the same idea (p. 13).

One important question to be addressed before drafting the model was the impact and the efficacy of the Eurohypothec, that is, what was to be changed in the European mortgage market and when. The resulting decision would not only alter the way in which the model was conceived, but also its scope.

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[6] At the moment of the copy-edit of this article, the Proposal of Directive of the European Parliament and of the Council on credit agreements relating to residential property (31-3-2011, COM(2011) 142 final) has been released. It deals with matters of consumers' protection in the field of mortgage credit agreements but only in relation to the "contractual" or "obligational" part of the agreement, without mentioning anything in relation to the mortgage itself.

[7] As an example, the Draft Common Frame of Reference 2009 does not mention the mortgage at all although deals to real-rights related institutions such as the acquisition and loss of ownsership of goods, proprietary security in movable assets and trusts.

[8] See below.

According to recently obtained results, the Eurohypothec is generating two effects:

1. At an initial stage, it is serving as:

– an inspiration for jurisdictions that do not have a well-functioning mortgage system or that do not have any at all (ie. as is still evidenced in some East-European countries).
– an inspiration to those jurisdictions that already have one, but are reforming it, in order to adapt to modern times and needs. The optimization of national mortgage legislations in Europe is being studied since 2006 by a research group called "Runder Tisch", whose results have been recently updated (Stöcker, Stürner, 2010) and are accordingly quoted thorough this work (Stöcker, Stürner, 2009)[9].
– a popular research topic. Pieces of work of practitioners and researchers worldwide (Baur, Stürner, 2009; Fiorentini, 2009; Scalamogna, 2005; Jardim, 2008; Watt, 2007; Sparkes, 2007; Steven, 2009; Diéguez Oliva, 2009; Van Erp, 2005; Akkermans, 2008; Marthinussen, 2009; Kenna, 2010; Dürr, 2009; Cuestas, 2010; Association of Insurance and Reinsurance of Turkey, 2005)[10] are dealing with core questions in relation to the Eurohypothec, such as its possible implementation in different jurisdictions, its model, its efficacy and efficiency in relation to national mortgages, its role in the harmonisation of European private law, discussions and improvements to the model, etc. Figure 1 shows the impact of the Eurohypothec among researchers in the world, including the so-called "Central-American Hypothec", developed upon the core elements of the Eurohypothec.

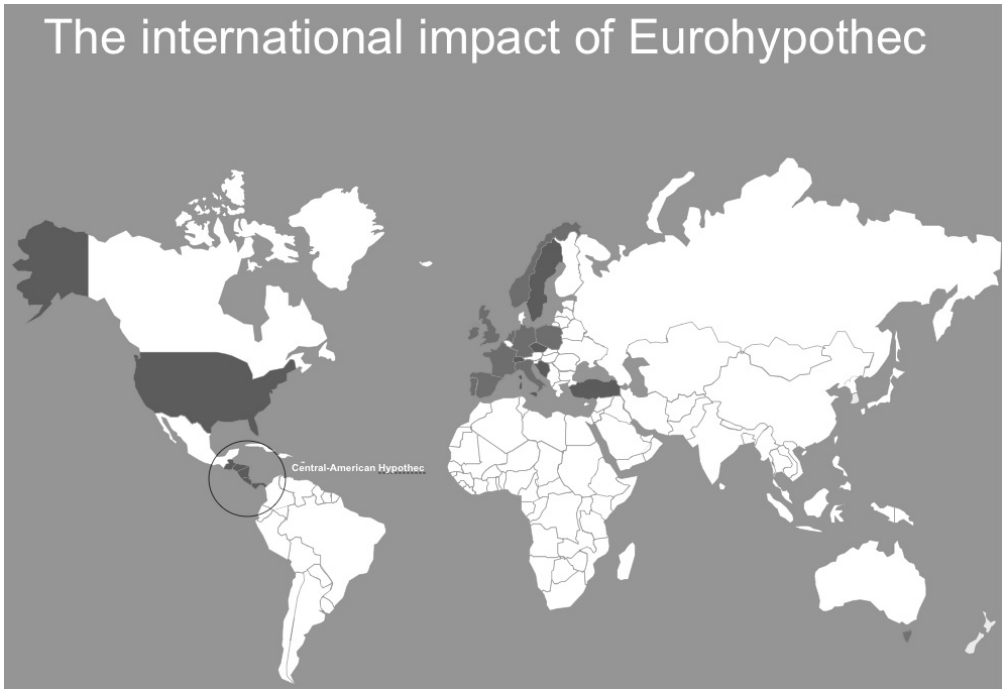

Figure 1. The international impact of the Eurohypothec. Source: own elaboration

[9] Maps used in this work come from this „Runder Tisch" 2009.

[10] Pieces of research of the drafters of the Eurohypothec's model 2005 are not quoted. Check, instead, the web www.eurohypothec.com.

In essence, the Eurohypothec model may indicate the direction to be taken by mortgage law reforms or implementations in national jurisdictions. That is, what challenges are to be achieved in the modern context of law of mortgages in Europe and what the benefits of a cross-border mortgage are.

In fact, following the introduction of the Basic Guidelines 2005, two "traditional" mortgage systems were reformed: the French, through the *Ordinance* 23-3-2006[11] and the Spanish one, through the Act 41/2007[12]. These share something in common: they both consider the flexibility of their mortgage laws, which to a large extent, coincides with the goal of usefulness through the flexibility that governs the Eurohypothec pursuant to the Basic Guidelines. However, neither of them – as we will see more in depth in the Spanish case – has achieved the Eurohypothec's level of flexibility/usefulness.

2. At a second stage. The Eurohypothec should serve as a common instrument for the European mortgage market, thus helping to fulfil the goals of the EU: freedom of people and freedom of capital throughout EU member states. It should be a useful and optimal common transnational mortgage instrument, parallel to the already existing national mortgages. This second stage does not require any changes to the legal framework for mortgages in any national jurisdiction.
3. At a third stage, national jurisdictions should realise the importance of adapting their own legislation to maximise the benefits provided by the Eurohypothec – once it is clear to them, for example, that their enforcement procedures are not timely or that their insolvency law does not sufficiently secure the mortgagee. These – and some other – factors would make the Eurohypothec granted in that particular country to be more expensive (more difficult to be granted, higher interest rate for the borrower) than the same instrument in another jurisdiction with better legal infrastructures, which would in turn cause prejudice amongst its citizens, thus leading to further legislative reforms.

2. WHY TALK ABOUT THE EUROHYPOTHEC?

As mentioned previously, the idea is far from new. Prof. Claudio Segré instigated the concept of creating a common mortgage instrument in the 60s – as commissioned by the EC. His proposed model was the Swiss *Schuldbrief*. Progressive work on the Eurohypothec, was undertaken in the following years by certain institutions such as the International Union of Latin Notaries and by renowned authors (more intensively by Prof. Wehrens (Wehrens, 1992: p. 557) and Dr. Stöcker (Stöcker, 1992)). In 2004, a special research group was set up to study the Eurohypothec (www.eurohypothec.com). This group not only organized several research events, but also took part in seminars that resulted in the redaction of the Basic Guidelines 2005, which also involved the participation of researchers from different groups and backgrounds. A few months later, the Internal Market Affairs Department of the European Commission issued the Green Paper on Mortgage Credit 2005, which at some point addressed a question considered by governments, mortgage market stakeholders and researchers on the usefulness and importance of the Eurohypothec. The response was very positive as can be seen in Table 1.

[11] Ordonnance n°2006-346, 23-3-2006 (JORF 24-3-2006).

[12] See below.

Table 1. Response to the Eurohypothec question as illustrated by the Green Paper on Mortgage Credit in the EU. Source: own elaboration

	IN FAVOR OF THE BASIC GUIDELINES EUROHYPOTHEC MODEL	IN FAVOR OF THE IDEA OF THE EUROHYPOTHEC, BUT WITH ANOTHER MODEL	HAVE DOUBTS/ NEED MORE INFORMATION	AGAINST THE EUROHYPOTHEC IDEA
GOVERNMENTS	CYPRUS POLAND CZECH REPUBLIK IRELAND FINNLAND	HUNGARY SPAIN	SWEDEN	EASTLAND GERMANY AUSTRIA
CORPORATIONS	Citigroup Inc., International SearchFlow, UK Crédit Agricole (CA), FR Halifax Bank of Scotland plc (HBOS), UK Lloyds TSB Group, UK Royal Bank of Scotland Group (RBS), UK	BBVA, ES	Baclays PLC, UK GMAC – RFC Limited, UK HVB Group, DE	ABN AMRO, NL Banca Intesa, IT
EU INSTITUTIONS	European Central Bank — Eurosystem, EU European Economic and Social Committee			

Although a more extensive study of these responses can be found elsewhere (Nasarre-Aznar, 2008), the conclusion to be derived is that most respondents were either in favour of regulating the Eurohypothec, according to the model foreseen in the Basic Guidelines 2005, or proposed another model.

Despite the positive response to the idea, the EU Commission relied only on the European Mortgage Federation to study the feasibility and interest of the institution, which created an ad-hoc group that was surprisingly closed during 2006 without any enthusiastic support for the creation of the Eurohypothec[13].

[13] This outcome ressembles to the one of the Directive Project 14-10-1998 on distant financial services to consumers. Also mortgages were excluded from the Directive 2008/48/EEC (Official Jornal of the European Union 22-5-2008, L 133/66) on credit agreements for consumers.

However, other sub-groups created by the EC Commission for the purpose of investigating other areas of the Green Paper worked more actively and with more enthusiasm towards European convergence in their fields of knowledge. In fact, they seized the opportunity to raise certain issues surrounding the mortgage market that substantially coincide with the features of the Eurohypothec, as foreseen in the Basic Guidelines. The two main reports relating to these issues included those of:

A) *The Mortgage industry consumer dialogue group (MICDG)*[14]. Composed of consumers and lenders, few agreements were concluded because of variations in opinions, which related to important matters. Conclusions in three very relevant areas were however achieved namely:

a) Precontractual information

- When should it be given? The question was related to whether it should be given before or after the customer had provided his details – the latter being the bank's option – and in which timeframe.
- Improvements to the ESIS (European Standardized Information Sheet), that is, whether the ESIS should include more accurate information in relation to the mortgage that the consumer was going to take out.
- Efficacy of the Code of Conduct on mortgages. While today, this is only a matter of voluntary application by some credit institutions in Europe, consumers in the subgroup wanted to make it compulsory, while banks considered that this would lead to more rigidities in mortgage operations[15].

b) Assessment

- INFORMATION (description of the product) should be differentiated from ASSESSMENT (recommendation of the product) and from RISK WARNING (lender should rate the indebtedness capacity of the borrower).

c) Pre-payment rights

- Significant differences exist between this being a contractual right (lenders) or a statutory right (consumers). In addressing country opinions, countries like Spain have granted to consumers a statutory right to enable prepayment of any amounts of the loan at any time – although in Spain, credit institutions are able to charge extra fees to compensate for the losses they may incur (prior to the Mortgage Reform 2007 – which attempts to address the problem – such losses were unduly calculated). The situation in other countries is the opposite: credit institutions and consumers may agree to foresee (more expensive mortgages, that is, worse conditions and higher in-

[14] Many of these issues are addressed in the above mentioned Directive Proposal of 31.3.2011 on credit agreements relating to residential property, such as the right of consumers to be properly informed in the pre-contractual phase (art. 9), the obligation to adapt this information in order to allow the consumer to evaluate if the offered mortgage credit is adapted to his needs and possibilities (art. 11), the obligation for credit institutions to assess the creditworthiness of the consumer and the impossibility to grant him a mortgage credit that he would be unable to repay according to the result of that assessment (art. 14), the obligation to the member states to allow the consumer to legally or contractually prepay the mortgage credit (art. 18) and even a model of a "European Standardised Information Sheet" (ESIS) to provide to consumers with a set of relevant issues of the contract (Annex II).

[15] See more details of the situation of the code of conduct (inspired by the European Mortgage Federation) at http://www.hypo.org/content/default.asp?PageID=224 and at http://www.cml.org.uk/cml/policy/issues/113 (UK Council of mortgage lenders).

terest rates for consumers in exchange of the freedom) or not to foresee (less expensive mortgages) prepayment rights for consumers.

This report was interesting for the Eurohypothec conception process because it made clear the point that the "contractual" aspect of a mortgage loan relationship is one thing, whilst its "real" (right in rem) part is another. The Eurohypothec has not necessarily connection to the contractual aspect of a mortgage loan (the loan contract itself); it is only related to the "right in rem" (security) aspect in the sense that it only deals with a model of security right on real estate, that is, the mode in which the lending contract, which will include all necessary consumer-protection issues, will be secured. Some other issues, like prepayment rights, may have a direct impact on the passive operations of the mortgage market, that is, the "stability" and "foreseeability" of mortgage securities (especially, covered bonds).

B) The *Mortgage funding expert group* (MFEG), composed only of lenders, of course, concluded more agreements. The issue relating to mortgage securities was precisely the central discussion point addressed by the MFEG. These discussions have produced some interesting points:

a) The concept of "**mortgage market**" is a complete one, as it includes both active operations (lending) and passive operations (mortgage funding). It now seems definitely clear that mortgage lending operations cannot be understood without a complete and well-functioning (from a financial and from a legal point of view) mortgage funding system.
b) Need to **integrate the mortgage market passive operations**. The fact that the well known US risk concept of "lending long, borrowing short" may still be a reality in Europe, implies the existence of inefficiency. 60% of all European mortgage loans (long term) are still inadequately funded by deposits (short term), which may cause mismatches, due to liquidity and interest rate changes (risks). As a consequence, only 17.5% are funded through covered/mortgage bonds whilst 10.5% are funded through mortgage-backed securities (MBS).
   - **Larger and more diversified** mortgage pools. The geographical diversification is one of the most important types of diversification that exists within those pools backing both the MBS and covered bonds. This is today, rather too complicated to be achieved at a Paneuropean level due to the low level of foreign mortgages that an EU credit institution has, mainly due to lack of a common mortgage instrument (the Eurohypothec).
   - Greater **diversity of mortgage products**. There are still several jurisdictions that lack specific well-functioning mortgage funding instruments, either covered bonds or MBS or both.
   - What characteristics should this Paneuropean mortgage market possess? **Completeness, competitiveness, efficiency, transparency and stability**. Completeness implies that every EU credit institution should possess the required facilities and capacity for choosing the mode of mortgage funding that it considers most appropriate; competitiveness refers to a subordination of all barriers to facilitate negotiation of cross-border loans with mortgage loans (obviously, the Eurohypothec should play an important role here); efficiency implies greater liquidity and product diversification, forgetting the importation of the US model of the Federal Agencies (Fannie Mae, Ginnie Mae and Freddie Mac), which have recent-

ly (first in 2004 and after then in 2008) been revealed as inadequate for a healthy mortgage market, although there have been some attempts to create the European Mortgage Finance Agency; product diversification in passive operations markets is difficult to achieve in an environment in which there is scarcity of transnational mortgage business; **transparency** infers that mortgage securities' legal and financial structures should be more comprehensible both for investors (both professional and non-professional) and for rating agencies; in fact, this has been one of the most important reasons for the internationalization of mortgage market crisis of Summer 2007: lack of transparency of the real risks that were borne by investors in MBS backed by sub-prime US mortgages, such as European professional investors linked to banks, funds or insurance companies; and stability refers to a process whereby passive operations of mortgage markets should bring about enough risk diversification into the mortgage markets.

- **Active operations**: pre-payment rights? – the same issue that is addressed by the MICDG but this time, due to the lack of consumer's participation in MFEG, clearer goals are achieved-; land valuation standards; flexibility of trans-national transfer of mortgages; efficient Land Register; efficient mortgage enforcement and consumer data protection.
- **Passive operations:** introduction of new legislations on covered bonds, to reduce risk in MBS pools and to create a truly Paneuropean market on mortgage securities. This is, of course, the ideal counterpart in the "passive side" for the Eurohypothec.

Therefore, even if the **White Paper 2007** of the EU Mortgage Credit had not specifically mentioned the Eurohypothec (it did in two Annexes), many of its principles and objectives would already be there. In essence, the creation of a true Paneuropean mortgage market cannot be achieved by addressing only the passive operations side.

Therefore, these are the key points of the White Paper 2007:

a) The mortgage credit market represents 47% of the European Union GDP. Therefore it is an important area, which should be **integrated**. This integration has been calculated to allow for an increase of 0.7 % of the EU GDP.
b) The EU Commission aims to **facilitate the cross-border supply** of mortgages (p. 3; bold is mine).
c) The EU Commission aims to facilitate cross-border funding of mortgage credit. It literally states that: "The existence of differing legal and consumer protection frameworks, fragmented infrastructures (e.g. credit registers), as well as lack of appropriate legal frameworks in some instances (e.g. for mortgage funding), **create legal and economic barriers, which restrict cross-border lending** and prevent the development of cost-efficient, pan-EU funding strategies. The Commission therefore seeks to remove disproportionate barriers, thus reducing the costs of selling mortgage products across the EU" (p. 3; bold is mine). It continues: "However, economic and **legal barriers also exist which prevent mortgage lenders from offering certain products in certain markets** or opting for a given funding strategy" (p. 3; bold is mine).

Therefore, although it does not mention the Eurohypothec, in these three points the White Paper 2007 talks about the same goal that Eurohypothec pursues.

d) As regards mortgage securitisation, it states that "The aim should be to facilitate, and not restrict, the **development of a wide range of mortgage funding instruments**"

(p. 4; bold is mine). As regards the use of pan-European mortgage loans to back covered bonds, it states that "the prohibition of including non-domestic EU mortgage loans in cover pools for covered bonds, which currently exists in some Member States, is compatible with the free movement of capital and the freedom to provide services" (p. 8). It envisages the creation of an Expert Group on Securitisation for 2008 (p. 9). The EU Commission refers to the same things we addressed with Eurosecuritisation and the cross-border transfer of mortgage loans to back covered bonds[16].

e) The EU Commission seeks to **facilitate customers' mobility** "by ensuring that consumers seeking to change mortgage lenders are not prevented or dissuaded from doing so as a result of the presence of unjustifiable legal or economic barriers", thus avoiding "tying" practices (p. 5). See below new restrictions by Spanish Act 41/2007 and the advantages of the Eurohypothec at this point.

f) The EU Commission encourages member states to join **EULIS**, which is commented on below as a good complement to the Eurohypothec: one cannot be fully understood without the other.

g) As conclusion, it draws the following: "To be effective, any proposed measures must demonstrate that they will **create new opportunities for mortgage lenders to access other markets and engage in cross-border activity**. They should also demonstrate the capacity to facilitate a more efficient mortgage lending process, with economies of scale and scope, which should lower costs. The expected benefits should be weighed against the possible costs of these measures" (bold is mine).

h) Finally, the Eurohypothec expressly appears in two Annexes of the White Paper:

– Annex 2: Process (Commission Staff Working Document-Accompanying the White Paper on the Integration of EU Mortgage Credit Markets-Impact Assessment), which states that the Eurohypothec (referred to as "Euromortgage") is a matter of study after the Green Paper 2005 release.

– Annex 3: Impact assessment on specific issues (Commission Staff Working Document-Accompanying the White Paper on the Integration of EU Mortgage Credit Markets-Impact Assessment, pp. 168 and 169), in the field of transfer of mortgage portfolios, a solution would be "to issue a recommendation to Member States […], to issue legislation or to create the '**Eurohypothec'**, as an alternative instrument for securing loans on property to existing national concepts of collateral" (bold is mine) and recommends further research.

3. NEED FOR THE EUROHYPOTHEC

The creation of a complete European mortgage market would not require a common mortgage instrument if the current situation and facilities were conducive for it. However, figures reveal that currently, only 1% of European mortgage lending operations are being undertaken cross-border (Green Paper 2005).

Broadly speaking, the European private law harmonization process has developed several ways of achieving integration but none of them have the capacity and resources required to create a single European mortgage market. Therefore:

[16] See below.

a) **Mutual recognition**. On the basis of the Cassis de Dijon resolution 1979, no barriers can be imposed on free circulation of merchandise if safety control requirements have already been fulfilled in an EU country. Several cases which followed Cassis de Dijon, like the Centros Case, Überseering and Inspire Art, have compelled other Member States to accept other EU states' corporative forms as the European Court of Justice recognises and acknowledges jurisdictions whose attributes make them valid anywhere in Europe. However, the mutual recognition principle applied to the diversity of mortgages in Europe (for sure more than 27) would mean that every national mortgage (each of the at least 27), as they are governed by the *lex rei sitae*, would be valid (should be able to be properly created) in every country, which would be completely chaotic for every jurisdiction (given the difficulty of integrating into one's jurisdiction more than 26 types of foreign mortgages).
b) In the field of **mortgages**, the most renowned case has been the Trummer and Mayer Case[17]. Austria had put in place a prohibition to create mortgages referenced to a foreign currency to avoid the publicity of a not-completely clear value of the mortgage (due to daily currency fluctuations). The European Court of Justice considered this reason as insufficiently strong to prevent the application of free movement of capital. Only if a national mortgage system were affected in such a way that it did not assure the rights of mortgage lenders and third parties, would this measure be acceptable.
c) **Transposition into a minus**. This principle implies that when a foreign right is incorporated into an EU country legislation, it should be applied in such a way that the owner of that right is not improved. However in the field of mortgages, this would mean that as regards a foreign mortgage, the mortgagee's position would be worsened when it was incorporated into a national jurisdiction's legislation.

Therefore, the Eurohypothec is not only fully compliant with the objectives of the White Paper 2007 and the most appropriate instrument to achieve them but also it bypasses the barriers of traditional ways of EU law harmonisation. Moreover, in the current context of international crisis, the Eurohypothec brings also certainty, trust and transparency to all mortgage operations (e.g. for securitisation purposes as establishes a clear-cut system of mortgage conveyance through the Eurotrust), following the intentions of the EU Regulation 1060/2009[18] on rating agencies.

4. IDEA BEHIND THE EUROHYPOTHEC

The Eurohypothec model presented in the Basic Guidelines 2005 was conceived as a **secure**, **flexible Paneuropean** instrument – which corresponds with the foundations of the White Paper 2007 on the integration of EU mortgage credit markets.

a) Security. The common core of all charges on land in Europe that may be used to secure obligations is that they can function as instruments enabling **land to be used as security** with some kind of **preference** – a claim that may be raised by a secured creditor. Apart from this starting point (using the land to secure debts with some kind of privileged right), no further common features may be found among any se-

[17] (C-222/97) ECR 1999, I-1661.

[18] Official Journal of the European Union 17-11-2009, L 302/1.

curing charge on land in Europe. The Eurohypothec should include this starting point in its foundations; however everything that is disconnected from it would appear unfamiliar to one or more legal jurisdictions (e.g. the contractual dependence arising from the secured obligation/s is not familiar to almost every South-European country; the fact that the Eurohypothec is able to secure all types of obligations – including the non-monetary ones – would come as a surprise to many common law lawyers, etc.). However, it would be unreasonable to discontinue with this integration for this reason. The Eurohypothec should be as **minimally intrusive** as possible to national jurisdictions but above every other thing, it should be **as much beneficial** as possible both to lender and borrower (this is its main cornerstone). To be effective, the Eurohypothec should have the same privileged rank in terms of foreclosure anywhere in Europe. However this cannot easily be achieved in the second phase; the above mentioned "third phase" is required, once a model has been agreed upon. This would be the optimal situation; if it is not legally possible, at least it should still have the same rank as other national mortgages (with which it would coexist). Finally, an excellent partner for the Eurohypothec would be a common European Land Register. A first step in this direction would involve the *European Land Information Service* (EULIS) Project (www.eulis.org), which during its first stage (lasting till 2004)[19], included two aspects: an on-line portal to access the already computerized national land registers and the "legal part" that includes definitions of legal institutions (in English) which are required to understand the legal situation of a plot of land (property, land charges, etc.) and their translation from one national language to the other. In its current stage, EULIS is fully operational and 5 national land registers and cadastres can be accessed through EULIS portal. Plans currently exist to extend it to many other registers and cadastres. As currently conceived, EULIS would serve as a useful tool not only to increase transnational land conveyancing, but also for the **registration** of land charges (lenders can easily check from his home country for all legal and physical details of the land that is to be accepted as security for the loan they intend to grant), which should evolve to true European e-conveyancing relating to land in future (in a similar way to what the English Land Registration Act 2002 foresees).

b) Flexibility. In order to be able to employ the Eurohypothec in every business involving mortgages conceivable today (and many others that could be conceived in the future that require a flexible real estate security), it should be "released" from those legal ties which restrict its flexibility: its legal accessoriness to the secured obligations. The Eurohypothec, as a right, should be regarded as an entity (**value**, in economic terms) on its own, disregarding the purpose for which it is being used at a particular point in time: from the passive perspective of being a charge over land, it should evolve to the more active one of making value of land by the mortgagor (who is, at the end of the day, the owner of the Eurohypothec once it is created). Only in such case could the Eurohypothec be assigned (by the lender/mortgagee) separately from the secured loan for funding purposes or would the borrower be able to reuse it for as many times as desired with the same or with a different lender. This should be understood as a general rule, which can be overlooked in some cases for consumer protection purposes (e.g. in the case where the lender assigns the Eurohypothec and

[19] Now EULIS holds a new project called Line (2010) to link EULIS system to the E-Justice programme.

the secured loan separately to two different third parties and both want foreclosure their rights against the borrower; in such a case, the latter should be entitled to invoke the relevant exceptions in order to avoid paying twice; this should be possible on the basis of the principle of unjust enrichment and on grounds of misbehaviour on the part of the lending institution[20]).

c) Paneuropean. This implies that the Eurohypothec should serve as a common instrument, accessible throughout Europe, disregarding any co-existence with other national types of mortgages. Based on what has already been said about its uses, flexibility and function as a security, finding an appropriate model for the Eurohypothec would be of great benefit. These are, broadly speaking, the basic hypothecs models currently in force in Europe:

– The continental accessory mortgage. This is the most widespread model type in Europe and this has led to some authors (Wachter, 1999: p. 49; Gómez Galligo, 2006: p. 927) proposing it as an ideal model for the Eurohypothec. It is present in almost every EU country but has disadvantages in relation to the independent mortgage. These disadvantages are linked to its legal accessoriness with the secured loan. This means that anything which happens to the contractual relationship between lender and borrower would also affect the hypothec (e.g. no hypothec may exist without a securing loan; once the loan is extinguished so is the hypothec; their assignment must take place at the same time etc.). However, authors supporting this idea do not provide any solutions that allow the accessory mortgages to undertake any type of business involving situations whereby the Eurohypothec can be combined with the Eurotrust[21].
– The continental European independent mortgage. It has its origins in Germany (*Sicherungsgrundschuld*) and Switzerland (*Schuldbrief*), but its use is widespread throughout the East-European countries such as Estonia (*Hüpoteek*), Poland (*Dług na nieruchomości*, still a project), Slovenia (*Zemljiszi dolg*) and Hungary (*önálló zálogjog*). Its advantage consists in being able to operate with any type of business and its disadvantage involves the hypothetical reduced protection for the borrower.
– The Scandinavian independent mortgage (Jensen, 2001)[22].
– The common law "mortgage", which is present, within the EU context, in the UK and in Ireland. Although certain features exist that make the common law mortgage as flexible as the continental independent mortgage (ie. its virtue to adapt to any type of loans, the possibility of creating or conveying it in equity, that is, with less requirements than with its legal form), the point is that the mortgage itself belongs to a specific legal environment: the common law and equity. The Anglo-American legal system cannot be exported as such, among other reasons, due to the fact that the mortgage entails a 3,000 year lease – which is still so in its legal nature – cannot be understood abroad; moreover, the fact that the mortgage is, at the same time, a loan and a *right in rem* is also a difficult concept to understand outside Anglo-American systems because civil law countries have a model of *rights in rem* that secure contracts and other obligations; and equitable mortgages (the ones normally used in many mortgage businesses) cannot be created or even understood in civil law juris-

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[20] See below.

[21] See below.

[22] As a general idea, one can agree that the Swede mortgage is an independent (from the loan) one and quite simple (the whole system of registration and dealing) compared to the majority of European models.

dictions. However, the wise use of the trust in combination to mortgage operations, rather common in common-law contexts, can dramatically improve the performance of the Eurohypothec[23].

From these models, it can be concluded that the Eurohypothec model in the Basic Guidelines 2005, has adopted the most appropriate aspects of each of the stated models to achieve the maximum possible level of security and flexibility and it can also be said that the result, the Eurohypothec, is a *tertium genus*. This is explained in the next point.

5. MODEL OF THE EUROHYPOTHEC IN THE BASIC GUIDELINES 2005

Here are the main features that help to build an operative concept of the Eurohypothec, which were incorporated in the Basic Guidelines 2005:

A) Concerning the legal nature

- It is a **real charge**, which confers on its owner a preferential right over a piece of land (i.e. using it as a security for a loan(s)).
- It does not substitute **national mortgages**; it should coexist with them in each national jurisdiction. This is fully in compliance with the aim of the White Paper 2007 of increasing the mortgage products' diversity (p. 4).
- It is **contractually dependent** on the obligations it secures; it may not require any obligation to exist.
- To be used as a security, a **security contract** should exist. It should provide for minimum contents (which obligations to secure, use of the Eurohypothec, conditions for redemption and enforcement). Form: *lex rei sitae* and art. 4.1 (c) Regulation 593/2008 on the law applicable to contractual obligations (Rome I)[24].
- Possibility for **complete redemption** (devolution) or a **partial** one.
- It does not generate interests; its constitution costs should be the same as those of national mortgages; the Eurohypothec extends to chattels and fruits of the land; it can be created in relation to any currency of the EU.

B) Constitution

- Only the **owner** of the land can create it, with or without the intervention of the creditor.
- It must be **registered** in the Land Register to exist (amount, owner and form).
- It can adopt **two forms**: "register Eurohypothec" and "letter Eurohypothec". It can be managed electronically.
- Object: **any land in Europe** and any other, according to *lex rei sitae*.
- **"Trans-national eurohypothecs"** and **"multi-parcel eurohypothecs"**.
- It is possible to hold a Eurohypothec or part of it on **trust** for another.

C) Transfer

- It will **depend** on the way it has been created: if it is a "register" Eurohypothec, transfer will be done through the Land Register; if it is a "letter" Eurohypothec, this will be done only by the delivery of the letter to the transferee.
- The Eurohypothec can be **conveyed independently of the secured obligation** to a different third party.

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[23] See the role of the Eurotrust below.

[24] Official Journal of the European Union 4-7-2008, L 177/6.

- The debtor can **oppose real pleas and objections** of the transferee. Therefore the security contract should affect third parties; if not, torts liability of transferor.

D) Extinction

- It is extinguished through **cancellation** in the Land Register, as a result of an agreement between the owner and, in its case, the creditor.
- **It is not extinguished** through passage of time.
- The **fulfilment** of a secured obligation **does not imply its extinguishment**; its effects will be determined in the security agreement.

E) Soft law: enforcement, registration and implementation

- Its **efficacy** depends on the **process and duration of its enforcement** (max.12 months)
- The Eurohypothec is an **enforceable title** in itself (*lex rei sitae*) + constitutes an enforceable claim against the owner (*Schuldversprechung*) (*lex rei sitae*; that is, only in those jurisdictions in which this is allowed).
- It should end through **sale at a public auction** (interdiction of *the droit de voi parée*).
- In the case of pleas and objections, the **burden of proof** lies with the owner of the Eurohypothec.
- Higher **ranked** rights stand still; those with the same or worse are extinguished; possibility of enforcer's substitution, replacing him and occupying his rank
- **Insolvency**. Same security as in enforcement. Possibility of separate enforcement.
- An **efficient Land Register** is required: public charges, rank and publicity.
- **Implementation**. Model to tend to and regime 28th.

6. QUESTIONS ABOUT THE MODEL

According to our experience and feed-backs we have received, several questions have arisen whenever the model was explained (European Bank for Reconstruction and Development, 2007).

a) Lack of **financial studies**. If the implementation of the Eurohypothec is a rather long and difficult way to walk, some studies should show in advance if it is a worthwhile process, economically speaking. However, working on the assumption that one common single instrument is better than having at least 27 different ones, may be enough. Moreover, the White Paper 2007 (p. 13) requires that any new measures "should demonstrate that they will create new opportunities for mortgage lenders", although it already includes some numbers that illustrate the benefits of mortgage markets' integration (pp. 3 to 5).

b) The proposed "**contractual dependent mortgage**" is **generally unknown** in Europe: this could generate concerns. Moreover, some models of legally dependent mortgages are flexible enough. Two main concerns always arise: the Eurohypothec, as foreseen in the Basic Guidelines 2005, cannot operate in causal jurisdictions, that is, in jurisdictions where the "*causa*" is a relevant requirement to compound a valid *negotium* (*Rechtsgeschäft*); the other one, that a separate transfer of the obligation to a first third party and the mortgage (Eurohypothec) to a second one will place the borrower in a difficult situation, as he would then have to face two different claims. Neither of both statements is true.

– Topic of ***causa* and accessoriness**. Although studied in depth elsewhere, Figure 2 shows those differences which exist between both: the *causa* refers to the obligation to create a security real right (or to use an already existing one) to guarantee

an obligation/s (*pactum de hipothecando*: the obligation of the mortgagor to create or employ a mortgage to guarantee certain obligation/s) while the accessoriness, although there are many types, refers to the link and grade of dependency between the security right and the obligation/s, that is, what happens to the security right when the obligation is transferred, diminished, or extinguished.

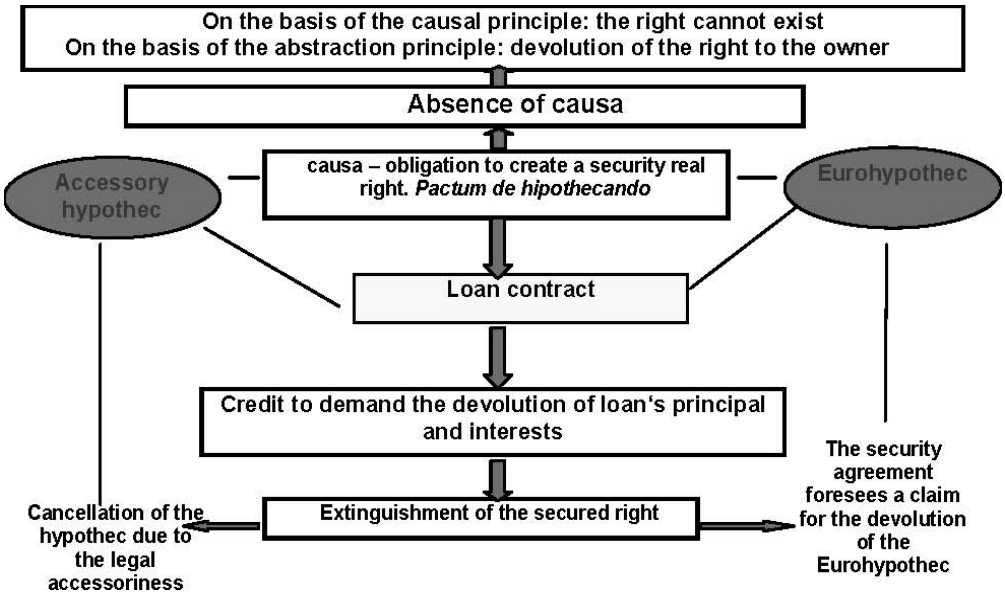

Figure 2. Causa and accessoriness. Source: Sergio Nasarre Aznar and Otmar Stöcker, *Un pas més en la 'mobilització' de la hipoteca: la naturalesa i la configuració jurídica d'una hipoteca independent*, "Revista Catalana de Dret Privat", Vol. I, 2002, p. 63

– On the topic of risk (for the borrowers) of **separate transfer** of mortgage and loan. Although this may be possible only if agreed with the borrower and mortgagor in the security contract, it would be necessary in some way to allow a Euro-securitization process through a Eurotrust[25]: that is, the secured loan alone should be able to be transferred to a Special Purpose Vehicle (SPV) – that which issues the MBS – while the Eurohypothec itself would be held by the originator on trust for the SPV. Therefore the normal case would be that the originator would retain the Eurohypothec and would only transfer the loan for mortgage funding purposes, and this is what would be agreed between the mortgage loan parties. However nothing would prevent the originator from transferring the loan to a first third party and conveying the Eurohypothec to another, thus compelling the mortgagor to face two possible claims (one from the transferee of the claim an the other from the transferee of the Eurohypothec). See the structure in Figure 3.

However, the debtor/mortgagor would be able to use all pleas and exceptions to protect himself, especially, that which states that he has already paid the loan, so he can stop the enforcement of the Eurohypothec. In any case, he would not need to pay twice[26].

[25] See below.

[26] This is the result of the implementation of the new §1192 Ab. (1a) BGB by the Art. 6 of the so-called

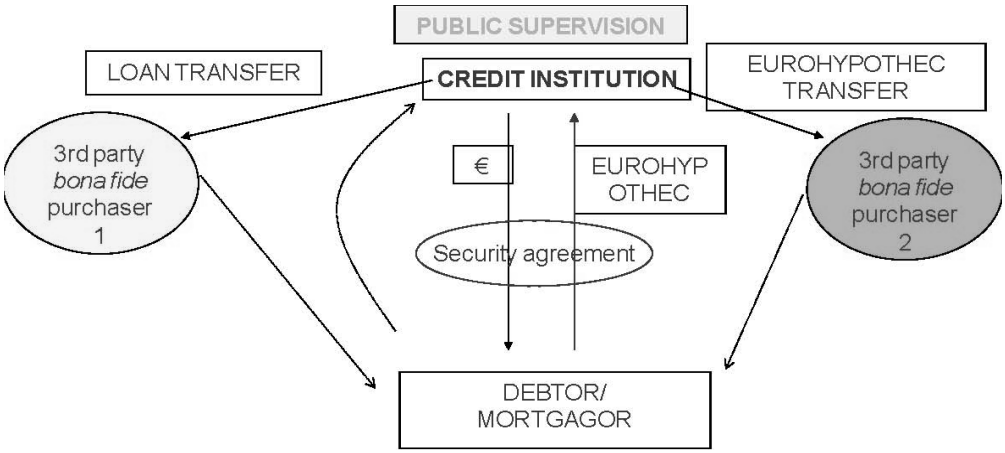

Figure 3. Debtor's risk facing two claims: from the lender and from the mortgagor. Source: own elaboration

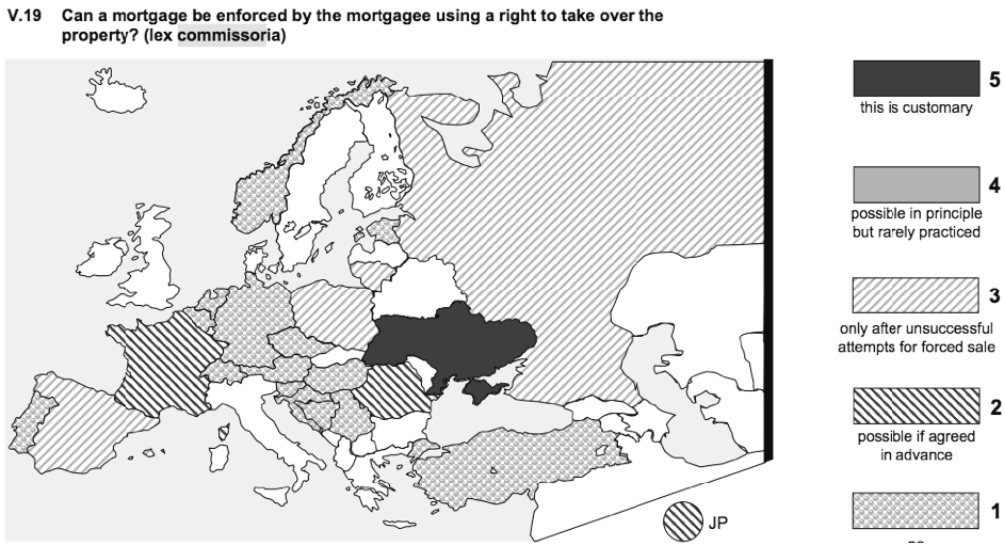

Figure 4. Level of acceptance of *lex commissoria* in Europe. Source: "Runder Tisch", 2009

c) In a third stage, **some fields of law will probably be affected**. However, these changes will be carried out spontaneously by national legislators to improve their Eurohypothecs. If a jurisdiction has a defective enforcement system that prevents speedy full recovery of the borrowed amount to the lender, few or more expensive (higher interest rates and worse conditions) Eurohypothecs would be granted in that coun-

Risikobegrenzungsgesetz 18-8-2008 (BGBl. I S. 1666 (Nr. 36)) by which the third party that acquires the Grundschuld is always affected by the contents of the security agreement, regardless whether he is or he is not a bona fide purchaser for value; thus, all exceptions and pleas –including the already paid premises on the mortgage- can be used by the debtor against him.

try when compared with other jurisdictions with better enforcement procedures. The same would happen with the insolvency context, the efficacy of the Land Register and all "soft law" that has been explained in the previous point, letter E. E.g. See in Figure 4 the significant differences throughout Europe in relation to the grade of acceptance of the *lex commissoria*.

d) **Scope of the Eurohypothec**: Should it be allowed only in the context of international transactions or also in domestic operations? Nothing should restrict the use of the Eurohypothec in domestic operations, if it would produce beneficial results for the parties involved. It should be presented as another option to them, separate from their national security rights on real estate. Should it be applicable only to professional lenders or also to non-professional lenders? This is not surprising to see in several national jurisdictions in which some security rights are only recommended for professional and controlled use (like the *Grundschuld* in Germany) or even legally limited to their use (the new *hipoteca recargable* in Spain).

e) **Competence** of the EU to implement it?
Under primary legislation, it is clear that the Eurohypothec is linked to the free movement of capital and people, which nowadays can only be achieved by an action of the EU, to which it is legitimated by art. 3b.3 EU Treaty. While the reference to free movement of capital is rather clear (trans-national active and passive mortgage operations will result in a Paneuropean movement of capital in relation to real estate), that which refers to people, implies the possibility of people easily financing their houses in another EU country from a national bank, not only for second-residences but also for geographical mobility of workers. They would be able to plan their movements abroad thus contracting with their national banks (theoretically with better conditions) in matters relating to the financing of their new house abroad.
The specific references in the Treaty of the European Union last amended by the Treaty of Lisbon 13-12-2007[27]: Art. 2.2 (freedom of movement and residence), internal market and economic union (arts. 2.3 and 2.4) and art. 6.1 which gives the Charter of Fundamental Rights of the European Union of 7-12-2000[28] last amended on 12-12-2007[29] the same legal value as the Treaties. In fact, it is this Charter that refers to the fundamental rights of property (art. 17.1), familiar, home and private life (art. 7), consumers' protection (Art. 38), help to families (art. 33.1), free movement and residence (art. 45), free movement of workers (art. 15) and, in general, the Charter of Rights seeks the „ free movement of persons, services, goods and capital, and the freedom of establishment" (Preamble).
In order to avoid too much intrusion in national laws, consideration of the application of the Eurohypothec as a "28th regime" seems to be a feasible solution.

f) The role of the **trust** in several civil law contexts is still in doubt. As we will see in the next part, the Eurotrust is an essential complement for the Eurohypothec.

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[27] Official Journal the European Union, 2007/C 306/01, Vol. 50, 17-12-2007.
[28] Official Journal the European Union, C 364/1, 18-12-2000.
[29] Official Journal of the European Union, C 303/15, 14-12-2007.

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