

Hungarian comments
on the Green Paper on Mortgage Credit in the EU, COM(2005) 327 final

The Hungarian Ministry of Finance and the Hungarian Ministry of Justice are convinced that the mortgage credit market forms a substantial part of the Hungarian economy just as the individual mortgage credit contract is a crucial step in a consumer's life. We fully support the Commission's intention on further integration of this significant and specific market. The Hungarian authorities (Hungarian Financial Supervisory Authority, Hungarian National Bank) also agree with these comments.

1. Consumer protection

As the consumer information is one of the basic rights of the consumers, we strongly support the strengthening of the European Standardised Information Sheet (ESIS) to reach a higher level of protection. On the basis of our practical experiences and of an internal study of the Institute for Financial Services the voluntary character of information is not efficient and does not guarantee the goal of a fully integrated market, thus the actual information provisions have not reached their full potential.

Regarding the information given to consumers, the provisions of the new Consumer Credit Directive (CCD) should be the basis bearing in mind that mortgage credit contract is more sophisticated and complex. A clear-cut and reasonable framework of information is a crucial aspect of best practice.

Concerning the timing of the provision of pre-contractual information, it should be at a stage that enables consumers to shop around and compare offers. Identification of a common stage for pre-contractual information on EU level is quite difficult, but not unrealizable. The provisions of the Directive 2002/65/EC concerning distance marketing of consumer financial services seem to be appropriately applicable – taking into account the method of communication between parties (e.g. distance communication).

As regards the relationship between the information provision and different participants (included brokers) in the credit contract, the obligation to provide information should be approached from the view of the consumer, regardless of the persons involved in the actual case.

In accordance with the content the Explanatory Memorandum of the proposal of the new CCD the duty to give advice is not separable from the obligation to provide information on mortgage credit. The pre-contractual information requirements can fulfil their role only if additional explanation is provided in order to enable the consumer to take a well-informed decision.

We consider that the real integration cannot take place without consistency in the area of early repayment. The Ministry of Finance supports the view of making the early repayment as a legal right of the consumer counterbalanced by reasonable fees. (The Hungarian National Bank supports making the early repayment a matter of choice of the consumer.) Instead of consumer education we recommend to include information to consumers on the right of early repayment within mandatory pre-contractual information. The purpose of the Annual Percentage Rate of Charge (APR) is to provide information and enable comparison of the offers. The comparison could be effective only in the case of uniform formulation in all

Member States. In spite of the difficulty of harmonization of this element we consider that only costs corresponding to services concluded via the creditor should be included. Other cost elements not specified in the APR should also be the subject of pre-contractual information.

Concerning the implications of usury rules we suggest examining it in a broader, non-mortgage specific context. In Hungary the circumstances of emergence of using usurious interest is ascertained by courts.

As regards standardisation of the terms of the credit contracts, the decision should be taken in line with the results of the European Contract Law initiative. Thus we support further examination of adjacent areas considering that mortgage credit is highly complex and a standardisation of the terms of the credit contracts seems to be realisable only via a 26th regime instrument for mortgage collateral.

2. Client credit-worthiness

As regards the database access for evaluation of client credit-worthiness we agree with guaranteeing only a mutual access to existing private and public databases on a non-discriminatory basis.

3. Funding of Mortgage Credit

We support the creation of an ad hoc stakeholders working group to examine the need for and nature of action on the funding aspects. Concerning the mortgage lending as an activity restricted to credit institution, in our opinion the same conditions and requirements should be specified for other institutions with this activity.

4. Applicable law

As regards the applicable law to the credit contract Hungary agrees with the second proposal put forward in the Green Paper, ie. continue to subject the credit contracts to the law chosen by the parties, subject to the application of the mandatory rules of the consumer's country of residence.

The law applicable to the mortgage contract/collateral should continue to be the *lex rei sitae*. It has to be noted – in accordance with the *Study on Property Law and Non-contractual Liability Law as they relate to Contract Law* submitted to the European Commission by the network coordinated by Professor Christian von Bar and Professor Ulrich Drobnig – that even with uniform choice of law provisions, „the differences between legal systems [...] act as a deterrent, the application of the provisions of private international law, even if uniformed, might discourage the granting of a cross-border mortgage credit”. However, should a Euromortgage be realised as a 26th regime, available in all Member States under the same rules, the significance of the differences arising from different choices of law and the situation of the property, will be less significant.

5. Forced sales procedure

With regard to the improvement of forced sales procedure, we approve of the gradual approach put forward in the Green Paper. However, it needs to be emphasized that beyond court enforcement, out-of-court enforcement procedures should be considered as well.

For instance, the Hungarian Civil Code (CC) – after stating in § 255 that the general (or default) rule is judicial enforcement of security rights – regulates out-of-court enforcement for all types of security rights. According to § 257 CC, the parties may agree also prior to default (ie. normally in their security agreement) that one of three methods of out-of-court enforcement will apply upon default: *i*) joint sale by the creditor and the debtor (mortgagee and mortgagor), *ii*) sale by the creditor (mortgagee) alone, if the encumbered asset has an official market price or the creditor is engaged in providing loans against security (e.g. mortgage loans) in a businesslike manner (ie. all credit institutions), *iii*) sale by a person appointed by the creditor (mortgagee), who is professionally or officially dealing with providing loans against security and/or organising auctions. In any case, the agreement must fix the lowest sales price or its method of calculation and must set the maximum period to complete the sale from the commencement of enforcement. A separate piece of legislation (a government decree from 2003) deals with the details of non-judicial (out-of-court) enforcement, e.g. the duty to give preliminary notice to the debtor. These ways of out-of-court enforcement may be used for any type of collateral, ie. also for immovables (real estate). The *Study on Property Law and Non-contractual Liability Law as they relate to Contract Law* submitted to the European Commission by the network coordinated by Professor Christian von Bar and Professor Ulrich Drobnig also refers to the laws of England, Scotland and the Netherlands which provide for a power of sale which can be exercised extra-judicially.

Court (judicial) enforcement can also be speeded up in Hungary by drafting the security agreement and the credit agreement in the form of a notarial deed, which – if it meets certain further criteria set forth in the Act on Judicial Enforcement – entitles the creditor to a court order for enforcement without the need for a lengthy proceeding.

As for the Hungarian experiences, the „joint sale” method of out-of-court enforcement has not proved successful in practice due to the lack of co-operation by debtors, but the other forms of out-of-court enforcement and the notarial deed as a way of speeding up judicial enforcement procedure are widely used. Out-of-court enforcement takes a minimum of 30 days from the delivery of the preliminary notice of enforcement. In practice, it is likely to take 60-90 days where there is a ready market for the charged assets. Judicial enforcement is likely to take about six to nine months for real property. The time can be considerably longer, however, in complex cases or where enforcement is contested. Judicial enforcement also involves more costs (fees) than extra-judicial enforcement.

The extra-judicial power of sale as an alternative method to court-led forced sales procedure should be taken into account in the collection of information to be carried out by the Commission.

6. Mortgage Collateral

With regard to the proposal to introduce a Euromortgage in the form of a 26th regime, two complex questions have to be answered: *a*) does the European Union need a 26th regime of security interest over immovables? *b*) if yes, is it the German model of non-accessoriness (or „contractual accessoriness”), ie. *Grundschild* to be relied on?

The first question is complex, since it is not clear how far would the regulation of a 26th regime of immovable security interest go. Presumably a regulation should go beyond general private law rules and rules should be developed for the enforcement outside and within insolvency proceedings as well, otherwise the Euromortgage would not be a uniform instrument giving the same rights and duties for debtor and creditor in all the Member States. But that may amount to harmonisation of the Member State rules on mortgage. If the

Euromortgage rules are more creditor-friendly than traditional Member State security rights over immovables, e.g. a Euromortgage would give a better satisfaction to the creditor in case of enforcement and insolvency, creditors will hardly accept any other form of security right over immovables even within purely domestic transactions. Thus a formally 26th regime might result in a *de facto* harmonisation of real estate secured lending.

Nevertheless it is undeniable that the divergent rules on mortgage operate as an impediment to cross-border mortgage lending in the EU and a 26th regime of security right over immovables would obviously contribute to the increase of cross-border finance in this field by reducing the risks and costs of these transactions and enhancing the funding of mortgage credit. The introduction of a 26th regime could be crucial from the point of view of integrating both the primary market of home loans and the secondary market of mortgage backed securities.

The second question, ie. which model to choose for a 26th regime of security right over immovables, seems more difficult to answer. Non-accessory mortgage is specific to the legal system of one Member State, i. e. Germany. Sweden and Finland seem to have rules on mortgage certificates with a weakened link between the secured claim and the security interest. Some of the new Member States have also introduced or re-introduced a non-accessory mortgage into their laws after the transition. This happened also in Hungary, where the pre-WWII „*telekadósság*” (literal translation of „*Grundschild*”) was revived under the new name „*önálló zálogjog*” (independent mortgage). However, in Hungary it is hardly used in practice except for home loans with state-subsidised interest rates, refinanced through Mortgage Backed Securities.

Ex lege accessoriness of the mortgage grants stronger protection to the debtor/owner than the contractual replacement of legal accessoriness through a fiduciary security agreement, the breach of which merely entails contractual liability, though the increased flexibility might in some cases be advantageous to the debtor/owner as well.

The Commission should undertake a comparison of the solutions provided by various types of accessory and non-accessory mortgage within the EU and decide on the basis of such an analysis whether the concept of „*ex lege* accessoriness” should be the model of a 26th regime or should it be given up and replaced by accessoriness through fiduciary agreement. (Fiduciary security rights are by no means generally accepted in Europe.)

For example, the Commission should take into consideration that the legal systems of Member States have developed such flexible instruments as e.g. the mortgage securing a maximum amount of debt arising from a specified relationship between debtor and creditor (the so-called *Höchstbetragshypothek*). Thus, when the debt has been partially or wholly repaid, a new debt can be secured by the same mortgage, the maximum amount mortgage can secure a fluctuating amount. An other alleged advantage of the non-accessory mortgage is that it can be transferred to a new creditor to secure a new loan, ie. the change to a new creditor is easier. The so-called „right to dispose with the ranking” and the „right to reserve the ranking” (i.e. in the land register) is essentially capable of the same: on repayment of the loan, the debtor/owner can either obtain new credit (credit from an other bank) and grant a mortgage with the same ranking to the new creditor or reserve the ranking of the mortgage for a year and grant a mortgage to a creditor within this period with the same ranking.

The Commission should undertake a careful, in-depth analysis of the alleged advantages of a non-accessory mortgage vis-a-vis accessory mortgages. A study should be carried out to see if the Member State regulations of accessory mortgage offer alternative solutions to the introduction of a Euro*Grundschild*. If the Member State laws on accessory mortgages do not provide solutions for the needs of modern financing – taking into consideration the legitimate interests of both creditors and debtors –, then the non-accessory mortgage should be the model of a 26th regime of security right over immovables.