

RESPONSE TO EUROPEAN COMMISSION GREEN PAPER ON THE MORTGAGE MARKET 19-7-2005

by

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I. Presentation and introduction

My experience in the field of the European mortgage markets comes from a triple source:

1. My research activity. Mainly due to research purposes, I started to study the European mortgage market in 1996. For my Ph.D. I was interested in legal aspects of mortgage securities (covered bonds and MBS, essentially). I undertook research for more than 30 countries (European and worldwide) and I published it in Spanish in 2003, under the title *La garantía de los valores hipotecarios* (The security of mortgage securities). It is a one thousand pages book, where I review there complicated aspects relating the security of covered bonds and MBS, their structure and enforcement and mortgage-related matters. After that, I have continued with this line of research until now, publishing another book, *Securitisation & mortgage bonds: legal aspects and harmonisation in Europe* and about 35 scientific articles in 7 European countries, reaching India, Egypt and Australia. The mortgage market, both lending and funding activities, in the European context has been my main field of research during these 9 years.
2. My assessment activity. Due to my work in the research field of mortgage operations, I have been assessing several private and public institutions worldwide, like the Spanish and Catalan Governments, the Spanish Land Registrars Chamber, among others, and co-operated with the Association of German Pfandbrief banks. I have also attended to many European-wide Conferences on covered bonds and mortgage market.
3. My activity as a Court of Appeal Substitute Magistrate. Although I have started recently as a judge, it has been an intense experience, having the opportunity to be in touch with the Spanish mortgage reality and the need for a trans-national pan- European mortgage business.

During these years of research this is the first time I see that the European Commission is really ready to bet for a true European mortgage market, which is really good news. I fully support the idea as I really see the need for it. The low trans-national mortgage operations at European level is really a ground for a worry, as this may be a cause for not fulfilling the European principles of free movement of capital and people.

I'll answer just some questions, referring some times to my already published works, in order to be as much concise as possible and avoiding repeating ideas. I also take part in the *The Eurohypothech: a common mortgage for Europe* research group (www.eurohypothech.com), which also sends its own response to this call of the EC, and

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I also have contributed to write the book *Basic guidelines for a Eurohypotheec* (Warsaw, 2005), which is quoted in the Green Paper; so I'll also refer to it at some point during the explanation.

II. Consumer's protection. Overall comment

1. The first point is that, when talking about the mortgage market, everything that is only loan or credit-related (and not collateral-related) should be studied separately, somewhere else, maybe in some specific consultation about consumers. The most important thing that would interest the future hypothetical mortgage market regulation is to structure a mortgage instrument that is useful for borrowers and lenders. That is, one thing is the loan/credit/secured obligation, in which context consumers' matters have full sense, as we are in the contractual field of law. But when talking about the collateral, the Eurohypotheec, only those aspects that are fully related to the mortgage configuration itself should be studied (i.e. remedies of mortgagor in case of execution, flexibility and security enough to grant mortgagors a peaceful acquisition of a dwelling/piece of land in general, etc.). Mixing up both things would deal to a complicated and fruitless discussion.

Information

2. Code of Conduct. It is a document of minimums but useful in jurisdictions that may lack "very basic" protections for borrowers. I particularly find interesting to compel by EU law such regulations in those jurisdictions where borrowers may be misinformed though no imposing it in jurisdictions where the protection is proved to be much higher.

Advice Provision and credit intermediation

3. Following the previous idea, borrowers should be advised as much as possible by lending institutions, who should be compelled to do so because maybe some borrowers would not be ready to understand what a mortgage could mean for him: not only acquiring his dwelling but also losing it in case he defaults. This assessment would help to avoid defaults and to avoid house enforcements and repossessions. This is good not only for the borrower (in the idea of consumers' protection) but also for institutional lenders as this would avoid the creation of "mortgage houses" (quite common these days in Spain), that is, institutions that are not considered credit institutions, which do not take deposits, which do not have liquidity controls or banking supervision at all, and repackage and rearrange all debts of borrowers. A good assessment by the credit institution (i.e. choosing a *Höchstbetragshypothek* instead of a normal one, which would include there as many credits as borrower and lender want to) would help the borrower to choose the best mortgage type or product without the need of finding extra information "outside" the "banking circuit" (which gives more guarantees than any other corporation that is not a bank or a building society or assimilated). This compulsory advise is increasingly important these days due to the phenomenon of the extra-communitarian immigration and those population sectors that, because of their particularities, are bad candidates to own a house in Europe because there are not adequate mortgage products for them; as mortgage products' range increase, so the information must also

increase. Moreover, experiences in some European countries (like the UK, with the problem of the overriding interests, in cases like *Chhokar v. Chhokar* (1983) 5 FLR 313 and *Malory v. Cheshire Holmes* (2002); and also at *Barclays Bank Plc. v. O'Brien* [1994], now solved by *Royal Bank of Scotland Plc. v. Etridge (No. 2)* [2002]) teach us that this advice is necessary not only to the borrower himself but also to any of those who may have any type of right on the charged property (i.e. partner, husband or wife, maybe children or other relatives living with together with the borrower), in order to avoid equitable implicit (equitable) rights to go ahead the lender's right of enforcement.

Early repayment

4. The early repayment should be a right of the mortgagor, as this should be a part of the pack of consumer's protections measures (this is only valid when the mortgagor has the condition of consumer; when the lending contract is made for commercial purposes –i.e. between a bank and a developer- this question makes not sense). This right, like some others that normally do not have the strong part in a contract, is based on the idea that the parties in a contract are not in the same conditions and do not act under the same conditions: there is a strong part (the lender, because he has the money) and a weak part (the borrower, as he needs the money) and their perspective in the lending contract is different: the former wants to make more business (the mortgage is a source of income and a basis for further mortgage market operations and profits in the form of mortgage securities) and the latter needs to take part to buy his house (for borrows the mortgage is a charge). So with consumers' measures, like this one allowing the borrower to get rid of this important charge of repaying such a huge amount of money (in case of a first house, maybe the biggest amount in his life), are just a matter of justice: the rules of obligations and contracts that are represent in Civil Codes European-wide are based on the idea that the parties are contracting under the same conditions and with perfect reciprocal interests. When this is not the case (like in a mortgage lending operation when one of the parties is a consumer), the law must act to re-establish this equality. So my opinion is strongly in favour in considering the early repayment a legal right of a consumer-mortgagor (not other types of borrowers). Of course, as a right and following the private-law principles of rights, this right to early repay can be waived by the mortgagor unilaterally, in a express way (Saying so) or in a tacit way (just waiting until the foreseen period of amortization of the mortgage credit and not exercising it). This waving option should be fully discretional by the mortgagor and should be not subjected to any amortisation plan or time-limit; this flexibility is according to the cases in which a mortgagor wants to pre-pay, like finding a better job, seasoning, inheritance, just have saved money for discharging his house, etc.

Another question is if the lender should be compensated in some way. In any case this should not be a right of the lender to impose fees but only a contractual option to do this. This is consistent with considering the right of early repayment as a way of compensating the position of the parties under the contract: but if another law allows fees, the compensation would never come true. Therefore, credit institutions may, according to the freedom of contracting which is in almost all civil law jurisdictions (either civil law or

common law), agree with borrowers the fees, although with legal limits (i.e. 0.5% or 1% at a max. of the outstanding amount of money to be repaid); capping is a good way of limiting these lenders' capacity of impose fees to avoid an abuse (The market would do the rest). This would only act as a way of discouraging borrowers to prepay until they have saved a relevant amount of money to repay.

Consumers must be informed about their right of early redemption at the same moment of signing the mortgage as a right for him in doing so and the costs that this would bear to him. Other ways could be through consumers' associations and, in jurisdictions without tradition, through mass media publicity. Moreover, lending institutions would treat this possibility as a good thing for borrowers and a positive aspect of their mortgage products, so they would also talk about this.

I leave the question about how this right of early payment would affect the mortgage securities markets for part V, which is about the mortgage market funding (through mortgage securities).

Usury rules

5. Usury rules are directly related to an unstructured lending market. When there is a banking authority –which is in charge of the banking supervision-, when there is a healthy pool of mortgage lenders, a good instrument for charging the land (i.e. Eurohypothecc), an effective mechanism of land publicity and a diversified and efficient system of mortgage market funding techniques, there is not a ground for usury rules. They are normally considered as a “last option”, which means some kind of “protecting net” that assures that interest rates and conditions of mortgage loans are not so terrible to be considered an abuse for the consumer. Therefore, usury rules should assure that borrowers do not fall into a “slavery” relation to the lending institution (i.e. because the interest rate is so high that they must work so hard that they only live not to be expelled from their houses) and that land is not so overcharged that it is expelled from the market. They must also ensure that the finality of lending for lenders is not acquiring the charged properties (due to massive repayments) but to promote the land market among borrowers (while doing business): the cause for a mortgage lending contract is to lend money to buy a house and not a ground for the lender to acquire a house in a cheap way (i.e. buying it in the auction that may follow the default of the borrower). So I personally think that usury is a last “ratio”, a point beyond which the lending contract loses its sense and changes into a source of fraud and occult interests. This could also happen in non-mortgage contexts: fears are the same (borrower's loose of freedom). So I am in favour of regulating some usury rules but so exaggerated that they would only mean that this lending-borrowing relationship is no longer healthy and has changed to another undesired relationship.

Enforcement

6. I find the mediation solution an interesting one to de-judicialize the enforcement of mortgage credits. But the problem is that, as this is a very sensible area not only of law but also in economics and in social contexts, the mediation solution should be done with all guarantees to assure rights not only of lenders but also of borrowers. So not every person is ready to be a

mediator in this field, as he might lack independence because lenders would be very much “appreciated clients” for him. Maybe specialized independent institution could be the solution, but they should be controlled by the relevant public authority to assure their independence and the rights, especially, of borrowers. This “supervised specialized mediator” is, in some sense, the role that a Notary public is doing in IULN (International Union of Latin Notaries) countries where he is allowed to carry out mortgage enforcements (i.e. Spain), but maybe his range of activities may be increased allowing him to mediate and trying to find alternative lending structures and formulas between lender and the defaulter to flexibilize their relationship thus avoiding the sale of the house.

However, in those jurisdictions where an efficient system of judicial enforcement already exists, maybe there is no reason to find alternative ways. Probably, thinking about the creation of a professionalized corps of European mediators is good idea, but could be quite bureaucratic but just another possibility among national solutions; I’d better leave to national laws the way in which mortgages (also transnational) are enforced.

III. Legal issues

7. The principle *lex rei sitae* is a quite suitable one, as it assures a common connection point among EU countries because it is present everywhere. And it is also a good point for mortgagors (especially consumers ones) as it is nearer to them (i.e. because it is where they live) than to the lender and they are used to it (i.e. everything related to land, not only mortgages, follow this principle, like for example the effects of property). Moreover, this principle is quite useful to be referred to in case, for example, of aspects of the Eurohypothech that cannot or may not or it is not needed to be harmonized (see the model of Eurohypothech in the book “Basic Guidelines”, already quoted in the Green Paper).
8. Cross-border access to databases. The lender must be able to ensure which grade of risk he wants to take with a particular mortgage credit. Moreover there is no constraint on sharing information among lending institutions in each country so I see no reason for constraining it at a European level, if there is a true interest in creating a European mortgage market. This does not necessarily mean that several population sectors would not be able to acquire a mortgage credit anywhere in Europe. It is an option for lending institutions both to design specific mortgage products for them (enlarge their range of mortgage products) and to compensate the risk in lending to them with a higher interest rate or more controlled conditions.

Property valuation

9. I see no need for the unification of the rules of property valuation. Every lender relies in a system and he knows and is used to know which is the risk that a particular valuation system reflects. In a free market, every expert may have his own system that is in some way tested and is used more or less extensively by lenders. So I see that there is not a better and a worse system of land valuation; only different techniques to do it which should suit the interests of both lenders (real market price until which the risk can be assumed) and borrowers (as much money as they can obtain from their piece of land).

IV. Mortgage collateral

Land Registers

10. The different working of national Land Registers should not be a problem if they give certainty of the ownership of a piece of land (who is the owner) and which charges are affecting the land. These two aspects are crucial and the very basic to allow any mortgage market because they give confidence to lenders. However 100% certainty is rather unattainable by current Land Register systems because they follow a general rule: what it is real and truth is the right that, according to civil law, a person effectively and validly has, disregarding what is recorded in the Land Register. While civil law give the titles, the Register shows them and give notice of them to third parties. I.e. one is a owner of a plot of land because he has inherit or bought it validly according to law and not because it is or it is not registered; this is only interesting for publicity purposes. Therefore, there are always in national law mechanisms of reconciliation between Registry Law and Civil Law, correcting the Land Register according what reality is.
11. The certainty about the legal status of the property or the encumbrances on a property directly depends on the efficacy of the Land Register to show the world who is the owner of a particular piece of land and how it is charged. However, not every land registration system works in the same way. Traditionally, there are three main registration systems worldwide, according to the effect of the registration, which means “what adds the registration of the deed/title to the transaction (sale, charge, etc.) of land”: the French system, the German system and the Torrens system. To these three, we should add a fourth one, which was introduced by the Land Registration Act 2002 in England and Wales.

French system. In the French system there is no need in registering to convey/create a right (including ownership) on land; the right on land or the conveyance requires only the agreement between the parties, so the main effect of non registering the rights on land is that they do not bind third parties (declarative effect), who have registered their right. This means that the Land Register in France does not show all rights (including ownership), charges and encumbrances that affect a piece of land, which are mainly living outside it.

The German Grundbuch is directly affected by the way in which rights on land are created in that country. The contract between the parties (anyone affecting the land, either selling it or charging it) is not taken into account because it is causally untied from the right in rem effect that is prosecuted (i.e. the sale contract has legally nothing to do with the effect of transferring the ownership). The right in rem effect has two parts: the *Einigung* (by which the transferee and the transferor agree to transfer the land, create or convey the right, etc.) and the *Eintragung* (the record of the transfer itself), so the registration is constitutive of the rights on land: no right affecting the land may exist unless it is registered. Once registered, what is registered is assumed to exist and to be exact, though this presumption is only *iuris tantum* (it may be destroyed by a proof on the contrary); anyone –a third party bona fide purchaser- who acts following what the Register says must

be protected. The Spanish system is a hybrid between the French and the German ones, as the registering is mainly declarative of rights to third parties, though the inscription of a hypothec is constitutive (no hypothecs may live outside the Register).

The Torrens system is similar to the German one –it was conceived on its basis- as it has also constitutive registration. The contract and the right in rem effect are causally linked. A peculiarity of the Torrens system is that, once the transfer/righth/charge is registered, a certificate of registered title is issued by the Land Registry Office and given to the title owner (and a copy is retained by the Land Registry). This title certificate that lives outside the Land Register, however, is only valid if it coincides with the copy in the Land Registry and its main effect is to proof and reflect what the Register says about a concrete piece of land. Moreover the title certificate is only valid if it has no problems like fraud in the registration, if registered rights are void, and some others.

The English Land Registration Act 2002 system. This law replaces “registration of title” with ‘title by registration’, which means that, through an e-conveyancing system, everything (relating to land) should be registered to exist. If someone pursues the modification of the legal reality (i.e. sale or mortgage a piece of land), he (together the buyer or the mortgagee) should do this going to a conveyancer (or similar), who will access an intranet and apply on-line (to the Land Registry) for the modification of the Land Register according to the will of the parties; the Land Registrar will check if there is no problem (i.e. the seller is registered as the current owner of the land) and then he’ll return the acceptance of the change; taxes will be paid and thereon the title on land is transferred or the land is charged. This system reflects in real time which is the status of a piece of land. This system is not fully in force yet but hopefully will be in a few years.

In conclusion, in general the Land Register (even in the Torrens system) never shows the real legal situation of a piece of land as they (in the German, Spanish and Torrens systems) work on the basis of *iuris tantum* presumptions that may be attacked in Courts by an owner of a contradictory title (who accordingly has the burden to proof that he has a better right than the registered owner). We should wait to see if the new English system will work on the basis of *iuris et de iure* presumptions (which does not admit discussion or contradiction) which would really mean that what is in the Land Register exists and what is not, does not exist, without any doubt (i.e. question of equitable rights, the doctrine of estoppel, etc.). Many vices could attack titles (i.e. in Spain if a sale is void –i.e. because the seller is a baby-, although the buyer is recorded in the Land Register, he is not the real owner of the land; this is not the case in Germany and in France such a registration may not exist; the Torrens’ solution would be the same as in Spain and, as the system is not still fully in force, there is a doubt who would control faithfully the capacity of the seller in England in a e-conveyancing system). So currently hardly none of the Land Registry organisations in Europe is ready to issue a Title (the so-called EuroTitle) –understood as a certificate- that can be used anywhere in Europe and that reflects the exact and

unquestioned reality of the legal status of a piece of land because the registered titles may be attacked from different flanks (problems with the contract agreement, the real right agreement, Land Registry law requirements, etc.). There is no unification of the causes that may affect the validity of a registered title so the information that may be seen, for example, on-line through EULIS, may reflect the situation in every Land Register at a certain point in time but, although the presumptions are in favour of the registered owner of the right (which mainly means that it is the other person, the one who discusses the registered title, who has the burden to prove the inaccuracy of the Register), the right may be declared void by a Court. This would happen in 25 different private-law environments, which affect the efficacy of Land Registration systems. Summing up, then, a good start for the EuroTitle should be to put clear which is the reliability of the published rights in each different Land Register, depending on the model they come from (constitutive or mere declarative registration, role in land conveyancing, etc.) and, after that, find out a list of vices (either on the title or in the registration itself) that may make the registered title void; and after that, Land Registries may issue a certificate (EuroTitle) that would reflect exactly which are the rights on a concrete piece of land, together with a list of possible problems with it. A harmonisation in the field of Land Register law, law of contracts and obligations and rights in rem is really a difficult task but now is time only to think about the beginning and the concept of the EuroTitle.

About the Eurotitle, I can recommend the following bibliography:

- Ploeger, Hendrik and Bastiaan van Loenen, 2004, At the Beginning of the Road to Harmonization of Land Registry in Europe, *European Review of Private Law* 2004, pp. 379-387.
- Ploeger, Hendrik and Bastiaan van Loenen, 2005, Harmonization of Land Registry in Europe, TS18 – Comparative Aspects of Land Administration Systems, From Pharaohs to Geoinformatics, FIG Working Week 2005 and GSDI-8, Cairo, Egypt April 16-21, 2005.
- Ploeger, Hendrik, Nasarre-Aznar, Sergio and Bastiaan van Loenen, “EuroTitle: a standard for European Land Registry. Paving the road to a common real estate market”, *GIM-International. The Global magazine for Geomatics* (www.gim-international.com), 2005.
- Ploeger, Hendrik, Nasarre-Aznar, Sergio and Bastiaan van Loenen, 2006, EuroTitle: Paving the road to a common real estate market, Edinburgh, in press.

12. EULIS. It was born with a limited scope: to create a web portal in which information from several national Land Registers and Cadasters may be shown and to create a Thesaurus with the most relevant vocabulary in different European languages. I find it is a great idea and the first step to a deeper convergence of European Land Registers. However, mortgage operations European-wide must know much more in depth what do all charges that are shown in every Land Register legally mean; therefore, more legal work must be undertaken. This is very important because an English “mortgage” does not have the same legal effects as a Spanish “hipoteca” or a

German “Grundschild”. They do not mean neither legally nor economically the same, because they do not affect the land in the same way; so this must be taken into account by all mortgage operators and this must be shown in this portal: knowing the charges is a important thing but understanding them is a crucial one. Maybe the Eurotitle –about which I have already talked- can be a second step. Moreover EULIS can be complemented by other Land Register systems that are being used in other several European countries, like Spain (www.registradores.org). Thus, sharing Land Register information is essential to promote a Paneuropean mortgage market because lenders would access easily and quickly to information provided by national Land Registers but one must be conscious and aware of six key points:

- a. The limitations of publicity by national registers: they do not show the reality; only presumptions
- b. The information provided through EULIS is not enough to allow a European mortgage market: it must be understood.
- c. In every country there are always hidden charges that are not shown in each Land Register.
- d. The Euroregister, though currently a chimera due to the different types of Land Register systems not only in Europe but also worldwide, can begin with EULIS. Both, the Euroregister and EULIS are excellent partners of the Eurohypothech
- e. Some kind of common title, like the Eurotitle, would benefit this paneuropean mortgage market.
- f. A Eurotrust (see below) is also a good partner for the Eurohypothech to allow paneuropean mortgage market funding techniques.
- g. And to fund a pool of Eurohypothechs, geographically diversified, one can start thinking about “Euro-covered bonds” or “Euro-MBS” (in general, “Eurohypothech securities”) in the terms that are explained below.

So, in my opinion, deeper research must be done and should be financed by the EU about the five legs of the European mortgage market stool: the Eurohypothech, the Euroregister, the Eurotrust, the Eurotitle and the so-called “Eurohypothech securities”.

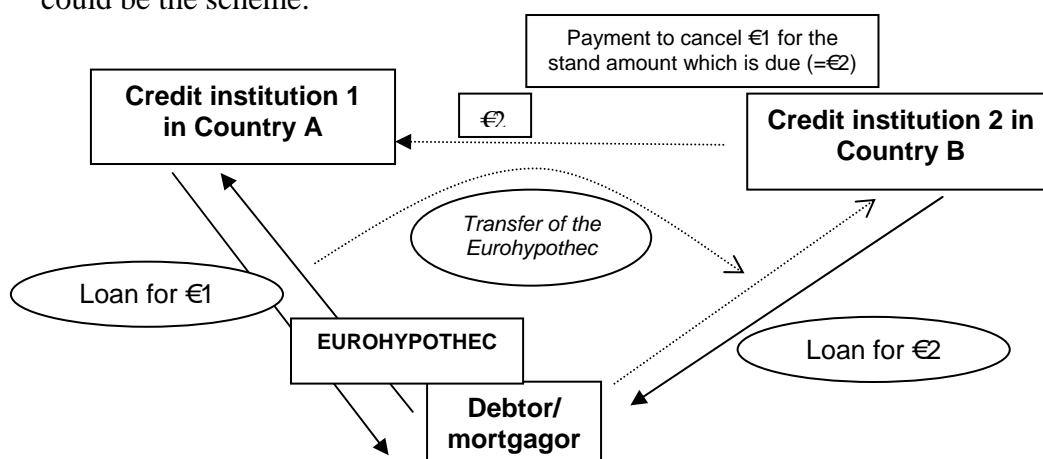
Euromortgage

13. Denomination. A better denomination than “Euromortgage” is “Eurohypothech” because it shows better the “collateral” nature of the instrument, disregarding the credit (obligation, loan, etc.) that is secured by this security right in rem. Moreover, according to English land law the “mortgage” has both a real and a personal nature, which is not the same in any other “hypothech” in Continental Europe nor should be with the Eurohypothech because it only refers to the collateral, to the security, and not to the personal part of the arrangement. Even the parties are different: in a Eurohypothech they are the mortgagee and the mortgagor and in the loan they are creditor and debtor (in economic terms, they are lender and borrower). So my first proposition is to change the name from Euromortgage to Eurohypothech.
14. I find the idea of the Eurohypothech extremely important and necessary for the development of a true European mortgage market. In fact, we would not

be able to talk about it unless we have a common instrument that may be recognized and used everywhere in Europe, which does not substitute any national mortgages or other land charge instruments and which gives the confidence to a Lender in Member Estate A to lend to a a Borrower in Member State B who gives a piece of land in Member State C as a security for his loan. With the increase in the use of the on-line banking, the on-line Eurohypothech would be an excellent solution for many and many borrowers European wide. And a extraordinary alternative to the local offer in case that, due to general economy reasons, interest rates, types and conditions of mortgage loans in a concrete Member State A are much better than the ones in Member State B, so their Eurohypothechs would be more suitable for borrowers in Member State B. And why would credit institution in Member State A lend the money? He would do so only in case he feels secured enough, which means, that he knows the effects and nature of the charge and he knows that the instrument he is using is strong enough to secure the loan, that it can be properly registered in the Land Register according to lex rei sitae (which would give notice to third parties), and that he would be able to recover the lent money (almost in full) even in case that the borrower defaults or goes into bankruptcy. These conditions can only be fulfilled, in a 25-country context through a common recognizable instrument: the Eurohypothech. Moreover there are many businesses that could be improved thanks to this geographic diversification and homogenization in the instrument that could be achieved. See some of them as examples:

A) A big advantage for borrowers: easy change of credit institution-easy refinancing

The Eurohypothech should guarantee a high grade of flexibility for the borrower in changing the lender, in case he finds a better one (following the idea of the obligation of the public authorities in protecting the weak part of the mortgage contract). This should be considered as an option of the borrower in doing so, in case he loses confidence in the first credit institution or he finds better conditions at any other European credit institution. This could be the scheme:



Other advantages for borrowers could be: joining all present and future debts with the same creditor under the same Eurohypothech, use different pieces of land that are in different EU countries as security for the same Eurohypothech (more risk diversification means lower interest rates),

possibility of re-arranging everything related to the credit without touching the Eurohypothech without extra costs, etc.

B) Interesting uses for lenders

- Creating paneuropean-international pools of Eurohypothechs for securitization and other funding techniques purposes
- Making extremely efficient syndicate lending businesses
- full freedom without costs in changing the conditions of the loan
- possibility of securing several credits with the same Eurohypothech
- expanding the market: lending accepting as a security any plot of land in Europe: no instrumental barriers
- etc.

15. The model. For long has been discussed since Segré Report in the 60s about the most suitable model. My participation began in 2001 and continued with the formation of the *The Eurohypothech: a common mortgage for Europe* research group (www.eurohypothech.com), to which answer to this call for contributions I refer to and to which I add the following personal comments. I took active part in the configuration of the Eurohypothech model which is in the *Basic Guidelines for a Eurohypothech* (Warsaw, 2005) and in the widespread of the idea of the Eurohypothech. In these *Basic Guidelines* were summarized the ideas of the participants, reaching a high grade of consensus on the model that would suit the needs of the market: flexibility and security for both, the lender and the borrowers, while thinking on a pan-European model. These are the main features of the proposed model:

A) Legal nature

- Real charge, which owner can obtain money from the charged piece of land in a privileged way
- It does not substitute national types mortgages, hypothechs or other real charges on land
- It is not necessary that exists a credit to secure. On the contrary of most types of hypothechs among civil law jurisdictions, it is legally independent (the law does not oblige credits and mortgages to be linked), though it can be structured contractually linked to the obligation (or obligations) that it secures at a certain point in time.
- To be used as a security to a credit it is necessary to sign a security agreement. It should have a minimal contents: which obligations are going to be secured by the Eurohypothech, uses of the Eurohypothech given as a security, redemption and enforcement requirements and conditions. The form of this convention should be given on the basis of the *lex rei sitae*.
- Chance of full or partial redemption of the Eurohypothech. Of course this redemption depends of the grade of coverage of the secured credit.
- It does not generate interests. Its constitution, cancellation, enforcement and any other costs should be the same of each type of national mortgages. The charging effects of the Eurohypothech would affect both chattels and fruits of the land and may be constituted in any currency among the EU.

B) Constitution

- The Eurohypothec is created by the owner of the land, with or without (where it is possible) the consent of the creditor (mortgagee)
- It should be recorded in the Land Registry. The minimum contents of the record is the amount of the Eurohypothec, its owner and the form in the way it is created (i.e. if it has been attached to a letter or it is simply considered a book-hypothec, which means that no letter has been issued)
- It can adopt to forms: book-Eurohypothec or letter-Eurohypothec. Its management may be done electronically.
- Object: land or any other according to the *lex rei sitae*
- Transnational Eurohypothecs and Jointeurohypothecs are also foreseen. The former allow to charge several pieces of land, which are allocated in several different EU countries. The latter allows the fact of creating a single Eurohypothec, while charging several pieces of land, disregarding where they are allocated; the way by which they are responsible depends on the *lex rei sitae*.
- It is possible to hold fiducially a Eurohypothec or a part of it.

C) Transfer

- It would depend on the way it is created (i.e. if it is attached to a letter, it would follow the rules of transferring chattels according to *lex rei sitae*; if it is a book-Eurohypothec, it would be transferred as land, according to *lex rei sitae*)
- It should be transferred independently from the secured obligation. A mechanism to protect good faith third parties and owner (mortgagor) has been foreseen.
- The mortgagor may oppose real rights of set off against the transferee. This is why the security contract may affect third parties to the Eurohypothec. The transferor is obliged to inform the mortgagor about the transfer and, in any case, the former would be liable for damages to the mortgagor.

D) Extinction

- The Eurohypothec is extinguished by cancellation of the entry in the Land Register, which could be applied by the owner of the charged land (mortgagor) and the creditor, if it exists.
- It does not disappear by the pass of time
- The full accomplishment of the secured obligation does not necessarily mean the extinction of the Eurohypothec. It would normally return to the hands of the mortgagor to be used, if he wants to, once again. The same happens with partial redemptions.

E) Enforcement

- It is essential to have an efficient enforcement system, as this is crucial for the success of the Eurohypothec. It should last max.12 months.
- The Eurohypothec could be an executive title according to the *lex rei sitae*, plus an executive action against the owner of the land (*Schuldverprechung*) (*lex rei sitae*)
- The enforcement should consist on the sale of the land in a public auction

- If the owner opposes to the execution, the burden of proof would rely on the mortgagee
- Once executed, rights on land with better rank stand still and disappear those with the same or worse rank. There is a chance for tacking.

F) Insolvency. In case of insolvency, the Eurohypothecc should have the same security as it has in case of enforcement. There should be the chance for a separated creditors' satisfaction from the general insolvency process.

G) Necessity of an effective Land Register system. Land Register should show charges, rank and publicity.

H) Implementation. The softer way is conceiving the Eurohypothecc as a model to tend, although there are many other stronger ways to implement it uniformly.

So, I fully support the idea of the Eurohypothecc as the only effective and feasible way (mutual recognition and other mechanisms either are not enough or are too complicated to be implemented) of creating a pan-european mortgage market. Studies about the implementation of the model in several countries are now being done with satisfactory provisional results. I insist in the need of joining the interests of every participant in the mortgage market (lending institutions, borrowers (consumers and others), land registrars, notaries and others who might be interested) in a common and the most useful model of Eurohypothecc which should join flexibility, security and paneuropeization. Moreover, the final model should be the less intrusive as possible to national legislations and should achieve the highest possible consent, but without losing its virtues of flexibility, security and usefulness.

The EU should follow, encourage and funding these academic and practitioners works to achieve this common standard which would help not only the lending sector but also the funding one of the European mortgage market.

The Eurohypothecc may be seen as the vehicle through which the European mortgage market should be created. It is the cornerstone of the whole paneuropean mortgage market.

To see more about the idea of the Eurohypothecc, I refer to the following articles (in English language):

- NASARRE-AZNAR, Sergio, "The Eurohypothecc: a common mortgage for Europe", *The Conveyancer and Property Lawyer* (United Kingdom), Thomson-Sweet & Maxwell, January-February 2005, págs. 32 a 52.
- NASARRE-AZNAR, Sergio, "Looking for a model for a Eurohypothecc". C. Schmidt (coord.), „Real Property Law and Procedure in the European Union“, Florence, 2005, in press (see it at www.iue.it).

For more references, check the page www.eurohypothecc.com and the references at the *Basic Guidelines*.

V. Funding of mortgage credit

16. I personally support the initiative of the Commission to take the funding side of the mortgage market into account for this Paper, as one cannot talk about a European common mortgage market without studying the impact and the role of the mortgage securities. My work in this field began in 1996, when I studied more than 30 mortgage funding systems and instruments in Europe and since then I have supported the idea of taking steps towards some sort of “informal convergence”.
17. This is not the first time that the EU considers the possibility of harmonizing mortgage market instruments in Europe (the *Directive Proposal about the harmonization about the issue of mortgage obligations* (XV/140/87/Rev. 1/DE) and the *Directive Proposal by the Commission to the Parliament about the freedom of establishment and services in the field of mortgage credit*, COM (84) 730) but it has been unsuccessful until now. Also private initiatives, like the *European Mortgage Finance Agency Project* (EMFA) (www.emfa.net) tried to reach this goal, but also without success (in this particular case, EMFA disregarded any type of legal harmonisation, only relying on a financial one, while it did not take into account the impact of a government-sponsored enterprise in a free financial market, while similar models are in a huge crisis in the USA). A conclusion may be drawn: maybe there is no need in harmonizing the funding side of the mortgage market in a formal way. In fact, other aspects should be taken into consideration:
 - a. While the mortgage instrument is harmonized, also the funding market is being harmonized, as the assets funded –the Eurohypothecs- would be the same European-wide, thanks to the reliability of the instrument and its good quality and standardisation. This is type of informal harmonization of the funding market.
 - b. It is a strong point to have different ways of mortgage funding, because the diversification of sources diminishes the risk of credit or interest risks (any kind of mismatch). Moreover, each type of instrument or technique is optimal for a type of mortgage loan (i.e. long term, short term, etc.) and for each of the needs of the funded credit institution (i.e. only funding but also risk managing (the ideal are MBS), only funding (covered bonds) or only risk managing (synthetic securitisation)).
 - c. From my point of view, introducing any type of standardised funding product is nowadays complicated and not desirable. Each national mortgage market has its own needs and they have adopted funding instruments according to their legal and financial structure (i.e. inventions like the *participaciones hipotecarias* or the *burdereau de cession* cannot be implemented or understood outside Spain and France, while an equitable transfer of mortgages cannot be done anywhere else in Europe than in England and in Ireland to issue MBS).

This is why I am particularly in favour of promoting an informal harmonization of the funding operations of the mortgage market: every European country should allow the issue of the two most important types of mortgage securities (MBS and covered bonds) through a framework

that gives certainty to those mortgage securities issued over a pool of Eurohypothechs (in fact, the minimum standard fixed by the UCITS Directive is the only think that standardises covered bonds in Europe and that guarantees some advantages to their issuers, like the 10% risk weighting). Then we'd be in condition to talk about the "Euro-covered bond" or the "Euro-MBS", that is, any type of mortgage secured issued over a pool of Eurohypothechs.

But what is decisively important to increase the use of covered bonds and MBS in Europe is to have an easily-negotiable Eurohypothech, which could be easily transferred and managed. This can be achieved through the model that have been explained above and that makes the Eurohypothech only contractually (and not legally) dependent on the particular (or some) obligation, credit or loan that are being secured at each point in time. In fact, in order to create remote and separate pools of Eurohypothechs or to pool those to transfer to another credit institution two basic features should be present:

- a. The possibility of splitting the Eurohypothech (guarantee) from the secured credit.
- b. The possibility of assigning credits alone to a trust (fiduciary pool), while the originator retains the Eurohypothechs (fiduciary assignment). The trust would be able to be managed by this other credit institution (i.e. the buyer of a whole covered bonds business from a bankrupted credit institution) or by a special purpose vehicle (SPV) which would issue MBS over this bankruptcy-remote vehicle. This fiduciary relation can be created through the Eurotrust.

For details of these techniques, of the needs of the European mortgage market and for more aspects of the harmonization of the funding operations of the mortgage market which have been already published, see:

- NASARRE-AZNAR, Sergio, *Securitisation & mortgage bonds: legal aspects and harmonisation in Europe*, Saffron Walden (UK), 2004, Gostick Hall Publications.
- NASARRE-AZNAR, Sergio and STÖCKER, Otmar, *Covered bonds in Europe*, at "Securitisation of derivatives and alternative asset classes. Yearbook 2005", Jan Job de Vries Robbé and Paul Ali (coords.), The Hague, 2005, Ed. Kluwer Law International, pp. 167-206.
- NASARRE-AZNAR, Sergio and STÖCKER, Otmar, *Eurohypothech and Eurotrust. Future instruments of a pan-European mortgage market*, "Securitisation of derivatives and alternative asset classes. Yearbook 2006", Jan Job de Vries Robbé and Paul Ali (coords.), The Hague, 2006, Ed. Kluwer Law International, in press.

One last remark is the preoccupation of credit institutions about the uncertainty that could exist if the Eurohypothech is so flexible for borrowers that makes their own funding businesses rather insecure and unforeseeable. At this point, one must say that the early repayment and the chance for borrowers to change credit institution are cornerstones for

a better mortgage market for all European citizens. Funding businesses for credit institutions, although could also benefit borrowers indirectly, are not. So European credit institutions should make efforts to readapt their funding structures to this new situation (especially in those countries where these rights are not fully implemented). As an example, covered bonds are normally said that always need very foreseeable mortgages to fund them; this is the case of the German *Pfandbrief*. But covered bonds are perfectly working in contexts less foreseeable, with variable interest rates and a quite freedom for borrowers to pre-amortize and to change the credit institution, like in Spain. The same case happens with MBS, which economic and legal context of the UK (the first issuer) is far from being the same of the MBS issued in Italy, France or Spain (the next major issuers). In fact they were born in the USA where the fixed interest rate mortgage is the most common one and they were adapted to the UK, where interest rates are capped or variable, or to Spain which are referenced. So financial structures can be readapted to every need with systems like the overcollateralisation techniques (some kind of big cushion to absorb changes in capital and interest rates), subordinated loans, insurance companies, *tranches*, etc. All these credit enhancement techniques are even more appreciated by rating agencies and the market. So maybe the Commission should not worry about a possible negative impact of the Eurohypothech and its flexibility to the funding market; it would be readapted.

According to the Green Paper, the Commission suggests the creation of an ad hoc group related to the topic of the mortgage securities in Europe. For my experience in this field and the research works that I have undertaken as an academic, I would be pleased to take part in it and to help the Commission in this process of mortgage market harmonisation in Europe.

VI. Conclusions

I see the mortgage market integration of the EU based in the following three points:

1. Matters credit-related and collateral-related should be treated separately, because one thing are the conditions and pacts stipulated in the lending contract (which is directly related to consumer protection, etc.) and other thing is the collateral and the way in which it charges the land, it is created, transferred and extinguished and all operations, both for borrowers and for lenders, that it should allow. They are two sides of the same coin, in some way related, but with their own particularities.
2. Consumers should be protected as much as possible because they are the weakest part in a mortgage loan contract and because what it is in danger is his house and his life project. This means, for the loan contract aspect, that the consumer should be well informed and that he always should have the right to redeem earlier and, for the collateral aspect, that the Eurohypothech should be beneficial for him, allowing him, for example, to change the lending institution at a low price and conserving the Eurohypothech.

3. There are five aspects that interact among them and that should be paid attention by the Commission:
- The Eurohypothec. This is the central institution for the creation of the European mortgage market. Following the model proposed in the *Basic Guidelines* and summed up here, it would bring reliability of the operators in lending under a mortgage anywhere in Europe and it would allow to make efficient business to them. To achieve this, it must be pan-European, flexible and secure.
 - The Eurotitle. After EULIS, operators would need a title that is reliable and that assures them that a particular mortgagor is the real owner of the land and that it is free of previous encumbrances. This institution must be studied further and it can be the first step towards a Eurolandregister.
 - The Eurolandregister. This is the last point in the converging mortgage market. Though currently quite chimerical, a common Land Register with the same type of records and the same type of reliability and efficacy against third parties would be ideal. However it is not a *prius* and a *condition sine qua non* for the Eurohypothec, as this can be developed under the current registrar rules in every European country.
 - The Eurotrust. This is important to allow fiduciary businesses with the Eurohypothec European-wide. This is very important to standardize and to allow mortgage funding structures.
 - Eurohypothec securities. This is the common name that can be given to those mortgage securities that are issued and fund Eurohypothecs. They are not harmonized mortgage securities –they can have different legal natures and financial structures– but what they have in common is that are covered and issued by Eurohypothecs that come from all around Europe.

This text above has been the contribution of Dr. Sergio Nasarre-Aznar to the Green Paper of the European Commission about the mortgage credit in the EU. For further information or for a closer collaboration, send an e-mail to sergio.nasarre@urv.net .