MORTGAGE CREDIT FOUNDATION

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Basic Guidelines for a Eurohypothec

Outcome of the Eurohypothec workshop November 2004 / April 2005

Edited by
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Mortgage Credit Foundation
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Foreword

Dear Sirs,

With a volume of more than 4 trillion Euros, mortgage loans in the EU Member States are of outstanding importance. Nevertheless, there is no internal market of mortgage loans, it is mostly a national one. The potentials of national markets are different and capital in Europe is not distributed equally. Legal differences between the national mortgage laws are one of the reasons for this.

For more than 40 years, there have been discussions and proposals concerning how to overcome these legal obstacles. A workshop which took place in November 2004 and April 2005 in Berlin developed for the first time a specific proposal of "Eurohypothec", a real estate collateral instrument for securing loans which could be common for all EU countries. Specialists, academics and practitioners from several countries and representing several European-wide expert groups, contributed their know how to this work.

Eurohypothec offers much broader possibilities of cross-border capital gathering and flow and allows capital allocation where it is most needed.

The new EU Member States still need investments to reach the same level as the old EU members, since their mortgage markets have not even totalled as much as 2% of the overall mortgage business in Europe. Poland's real estate and mortgage business has been very dynamic over the past years. It was possible, because, as in the other new Member States, over the past years Poland modernised its real estate law and its mortgage law to create better conditions for foreign investment, including the real estate collateral infrastructure.

The challenge of the European Union to create new instruments on the basis of different legal traditions is very well known to Poland. On the present territory of Poland, French, Prussian, Austrian, Russian and of course Polish law existed during the last 200 years, the more or less clear consequences of which may be still observed today. The experience of Polish lawyers and Parliaments struggling to come along with different legal cultures and to develop something new out of it could contribute to the solutions applied in the EU of today.

This demonstrates very well the work of the Polish Parliament on the creation of a flexible (non-accessory) real estate security right, called "dług gruntowy" (land debt). The project to implement a new type of mortgage collateral into the Polish law system, in addition to accessory mortgage, has proven as realistic and showed that it is possible to combine such a modern collateral instrument fulfilling many of the guidelines of Eurohypothec, with Polish land register, enforcement procedure and insolvency law.

In view of such challenges, participation in the workshop which took place in November 2004 and April 2005 in Berlin seemed very important and I would like to express my thanks to the organisers and participants of this event. It was in fact a very good opportunity to discuss the experience of different countries regarding the search for system solutions for the most effective real estate collateral instruments i.e. instruments which prove efficient in both standard and more sophisticated cases.

The highest professional level and the thorough knowledge of the issue among the discussion participants allowed for reaching beyond the national legal habits and creating a common Eurohypothec concept, which respects individual countries' achievements and experience regarding mortgages as well as 40 years of discussion on Eurohypothec held in other groups.

The more glad am I presenting you with this publication. I believe that it will become an important milestone in the development of the Eurohypothec concept and will constitute a basis for a constructive discussion. You are welcome to discuss the above issues on the dedicated electronic platform at **www.fukrehip.pl.**

Dr. Agnieszka Drewicz-Tułodziecka

President of the Mortgage Credit Foundation

Participants of the workshop on Eurohypothec, Berlin November 2004/ April 2005

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CONTENT

Introduction

1. The Idea of the Eurohypothec

1.1. Segré Report

In 1966, the "Segré Report" on "The Development of a European Capital Market" held: An approximation or harmonisation of the laws on security rights within the individual Member States should be considered a priority. The land charge described in the previous chapter could play a vital role in funding the building of houses, as it is more adaptable and cheaper than the hypothec. It would also be appropriate to allow mortgage and land charge entries to be made in a currency other than the national currency. The introduction of a mortgage common to all Member States would help to integrate capital markets.

1.2. UINL Commission

In 1987, a commission of the International Union of Latin Notaries (UINL) proposed that

- along with the existing security rights over real property in the individual Member States (such as mortgages, land charges etc), a pan-European mortgage should be introduced in all Member States and made available to lending institutions;
- this uniformly regulated security right over real property should be structured largely on the example of the Swiss certificate of indebtedness (Schuldbrief);
- lending institutions and borrowers within the EC would thereby be offered a more marketable and versatile security right over real property as an alternative to the existing security rights over real property in each Member State; and
- in this way any legal, economic and practical disadvantages of the conventional strictly accessory mortgage would be avoided.

1.3. VDH model law

In 1998, the Association of German Mortgage Banks (VDH), with the help of a team of experts from both academic and practical backgrounds, developed guidelines for a flexible non-accessory security right, which provided the foundation for consultancy work carried out by VDH in central and eastern European countries involved in reforms and the development of modern laws on security for loans.

1.4. Reforms in Central and Eastern European Countries

Meanwhile Estonia, Hungary and Slovenia introduced non-accessory mortgages. In Bosnia and Poland draft laws on non-accessory mortgages have been introduced in Parliament.

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1.5. Research Group "The Eurohypothec: a common mortgage for Europe"

Since a meeting at the University of Valladolid in June 2004, these guidelines have been further developed by a pan-European group of experts launched in Spain, but consisting of members of 5 European states, known as "The Eurohypothec"[1]. The members of this group have published several articles on this topic and have organized a number of international conferences. They contributed to the drafting of the first set of Eurohypothec guidelines in 2004.

1.6. Forum Group on Mortgage Credit

In 2004, the new guidelines were also taken into account by the "Collateral" Sub-Committee of the Forum Group on Mortgage Credit, established by the European Commission, DG Market[2].

In its final report, the Forum Group considered the Euromortgage (Eurohypothec) to be an alternative tool to facilitate the transfer of mortgages which could be introduced by Member States without substantial changes to their existing legal systems, operating as it would under the rule of lex rei sitae[3].

1.7. Comparative Study of the European University Institute

In 2004/2005, the European University Institute (EUI) in Florence, in cooperation with DNotI (German Notary Institute) and with specialists from various EU States, undertook a comparison of property law in EU countries. This comparison, which is now under completion, also covers security rights, so important preliminary work on a Eurohypothec is also being done here. A comparative report is to be published in 2005.

1.8. Trento Group

Presently, the "Trento Group"[4], consisting of a number of academics and practitioners, are commencing discussions on European mortgage law.

1.9. EULIS

Since 2002, EULIS (the European Land Information Service[5]) has been developed. 8 European countries are currently involved: Austria, England and Wales, Finland, Lithuania, the Netherlands, Norway, Scotland and Sweden.

The project was finished in June 2004. The aim of the project, which was to develop a common internet portal allowing access to land registers across Europe, was successfully accomplished. The EULIS partners' intention is to have the service fully opera-

[1] www.eurohypothec.com
[2] The recommendations of the Forum Group are published in Annex D.
[3] Final report, number 117.
[4] www.jus.unitn.it/dsg/common-core
[5] www.eulis.org

tional and open to professional users by September 2005. With this aim in mind, groups across Europe are not only systematically examining and comparing national land register and recording systems but are also conducting an in-depth comparative-law review of the range of rights registered – including security rights over real property.

2. Groups contributing to this paper

On the initiative of the research group "The Eurohypothec: a common mortgage for Europe", two workshops were organized in Berlin in October 2004 and April 2005 in order to combine the ideas of the different research groups with the members of the Subgroup Collateral of the Forum-Group on Mortgage Credit and other practitioners.

Thus, the following groups have contributed to the present paper:

- the research group "The Eurohypothec: a common mortgage for Europe"
- the members of the Forum-Group on Mortgage Credit, Subgroup Collateral,
- EULIS (European Land Information Service)
- European University Institute

3. Outcome of the workshop

The creation of a concept of Eurohypothec in the different Member States as an additional tool seems to be appropriate to facilitate the development of a transnational credit market (B I).

This paper considers how such a Eurohypothec might be structured, as a national tool, based on the principle of the lex rei sitae, but nevertheless ensuring certain common European standards which would make cross-border transfers of the Eurohypothec easier (Part B II).

The transferability and the economic value not only of the Eurohypothec, but of all mortgages, depends on its legal environment, in particular a transparent land registration system, where all relevant charges on the land can be checked by the prospective creditor, and effective enforcement procedures (Part B III).

With this paper, the workshop aims to give basic guidelines for the implementation of a Eurohypothec.

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A. Participants of the workshop on Eurohypothec, Berlin November 2004/ April 2005

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Since 1996, researching mortgage markets (both lending and funding sides). Since 2001, researching the Eurohypothec. Author of several publications on these topics in some European countries. Member of the "The Eurohypothec" research group.

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Since 1989, dealing with mortgage law and cross border real estate lending in Europe, adviser of EU accession countries in real estate law and author of various publications on the Eurohypothec.

2. Members of the Forum-Group, Subgroup Collateral

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Dealing with international real property and land law issues, with a particular focus on land registers in Europe. Since 2002, involved in EULIS as one of two project managers.

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Andreas Luckow
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B. Working paper "Basic guidelines for a Eurohypothec"

B.I. Objectives of the Paper

1. Objectives

1.1. Problem

The different European mortgage law systems show important rigidities and inflexibilities in particular as regards cross border lending. Further, the existence of different mortgage systems in each of the EU Member States leads to difficulties in cross-border mortgage lending. Currently, cross-border lending is assumed to represent only 1% of the total amount of mortgage business.

1.2. Solution

A flexible but still secure common hypothec for Europe (the Eurohypothec) will help solve the problems mentioned in the preceding paragraph, if it is adapted to the modern requirements of real estate finance. To achieve these aims, one of the best tools available is a non-accessory security right (the Eurohypothec).

1.3. Creation (setting up) independent of the secured claim

The Eurohypothec can exist before the loan agreement is concluded or before the loan is disbursed. Disbursement of the loan is thereby made easier: the bank does not have to bear the risk of making a disbursement in the absence of a security right. The borrower is therefore able to create a security right over real property prior to or during loan negotiations and disbursement of the loan on conclusion of contract can thus be considerably speeded up.

1.4. Repeated Use of the Eurohypothec

When the obligation to be secured has been partially or wholly repaid, a new obligation between the same parties can be secured by the same Eurohypothec without a new one having to be created. This is a major advantage for consumers.

1.5. Securing fluctuating amounts

The Eurohypothec can easily be used to secure debts of fluctuating amounts; this is a major advantage for real estate development financing and phased construction, as well as for current account-related debts.

1.6. Reduction of costs

The possibility of re-using the Eurohypothec will lead to a reduction of costs in the creation of the security right.

1.7. Novation and change of obligations

It is also possible to retain the same Eurohypothec as a security device when the obligation secured is to be replaced by a new obligation (novation). A fixed-rate loan can likewise be extended or replaced after expiry of the fixed-interest period by a loan for the subsequent interest period. The same applies when several small obligations are to be replaced by one large obligation.

1.8. Multipurpose Hypothec

The Eurohypothec can be used to secure several obligations of the same creditor.

1.9. More Competition among lenders

The flexibility of the Eurohypothec makes the change to a new creditor easier and thus promotes competition among lenders. Due to its non-accessory nature, it can be transferred to a new creditor to secure a new loan. This is another major advantage for consumers.

1.10. Improvement of Funding

The Eurohypothec supports the development of new funding techniques by banks. Simplified means of transferal make it possible for credit institutions to transfer loans secured by Eurohypothecs to other credit institutions. It is also easier for banks to acquire other obligations secured by Eurohypothecs, without the high costs in terms of time and expense, in order to improve their risk structure. Furthermore, it helps to concentrate the loans with financial institutions offering the best funding possibilities so that the market can propose better terms. This is helpful in enlarging markets for covered bonds and mortgage-backed securities (MBS).

1.11. Improvement of financial transactions

The transfer possibilities also allow parts of mortgage loans to be transferred between financial institutions quickly and economically, in a form that is insolvency-proof. It is possible for the parties of syndicate loans thus formed to diversify risks and to grant large scale-loans.

1.12. Aptness for electronic registration

A computerized handling of mortgages is not necessary for the Eurohypothec, but it is clear that computerization makes cross-border lending easier. The simple registration of the non-accessory Eurohypothec makes it suitable for computerized registers as well as for electronic applications.

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The certificated right is in this context preferable, since all new transactions that affect the Eurohypothec, such as assignments, can take place without the need of changes in the register.

Future reforms towards a totally computerized handling would be electronic certificates and electronic obligations. The Eurohypothec is constructed to adapt to such a process.

B.II. The Eurohypothec

2. Principles

2.1. Eurohypothec

The Eurohypothec is a non-accessory land charge entitling the holder of the Eurohypothec to the payment of a certain sum of money out of the property right. Regularly it is used in combination with a security agreement.

2.2. Security Agreement

The security agreement stipulates under which the holder of the Eurohypothec may keep and enforce the Eurohypothec.

The security agreement is not the same as the loan contract. However, it may be included in the same document as the loan contract.

2.3. Lex Rei Sitae

The law of the Member State where the property is located (lex rei sitae) is applicable to the Eurohypothec, including the competent land register, the certificate of the Eurohypothec, and to any related security agreement.

3. Creation

3.1. Owner's Consent

Only the land owner can create a Eurohypothec. The land owner and the debtor of the secured claim may be two different persons.

National law may require an agreement between the owner and the future holder of the Eurohypothec as a substantive requirement for the creation of the Eurohypothec.

3.2. Registration and Formal Requirements

Within the framework of registration (number 7) the following principles apply to the Eurohypothec:

Opposability (third party effect): The Eurohypothec must be registered in the competent national register as defined by national law.

Only when registered, the Eurohypothec is opposable against third parties.

Formal Requirements: Formal requirements as regards the declarations of the parties and registration are the same as for other real estate charges (mortgages) under national law.

Contents of Registration: Registration should contain the following points:

- the amount and currency of money payable[6] ,
- the name of the holder of the Eurohypothec,
- whether it is a certificated right (letter right) or a non-certificated right (non-letter right) (if the national law provides for both versions),
- whether or not the Eurohypothec is enforceable (if it is not yet enforceable by law),
- in the case of a multi-parcel (joint) Eurohypothec, the other land charged.

3.3. Certificated Right and Non-Certificated Right

National law may provide that the Eurohypothec be structured either as a certificated right (letter right) or as a non-certificated right (registered only right or non-letter right), according to the parties' choice.

The land register should state whether it is a certificated right or a non-certificated right, if the national law provides for both possibilities.

3.4. Payment

Capital Amount: The holder of the Eurohypothec is entitled to payment of the capital as registered. It must be a claim for payment of money.

The currency of any EU Member State may be used for the Eurohypothec; national law may provide that it also be created in another currency.

Interest: The Eurohypothec does not yield interest[7].

Secured Claim: The creation, transfer and existence of the Eurohypothec and the exercise of the rights therein is not dependent on the existence of the secured claims[8].

However, if the Eurohypothec is used for security purposes, the owner can object if the holder of the Eurohypothec exercises rights under the Eurohypothec which are not given to him under the terms of the security agreement.

3.5. Object

Land: A Eurohypothec may be charged on land situated in any Member State of the European Union.

[6] This currency and amount may differ from the amount payable according to the contractual agreement

[7] Some members propose that the national law may provide for the Eurohypothec to yield interest, which may differ from the interest rate agreed upon in the loan contract. The interest rate (or in the case of a flexible interest rate, the maximum rate) must be registered in the land register.

[8] The causa of the Eurohypothec may lie in the security agreement or in a separate duty to create a Eurohypothec which might be included in the same document as the loan contract (see part C-2. II).

Other Charged Objects: The lex rei sitae determines to what extent land, but also buildings owned independently of the land or any another land charge or Eurohypothec, may be charged with an Eurohypothec. (In the case of a land charge, it will be called a sub-Eurohypothec).

Multi-Parcel (Joint) or Transnational Eurohypothecs: National law must provide for the possibility of several pieces of land situated within the same Member State to be charged under a single Eurohypothec (joint or multi-parcel Eurohypothecs).

Several Eurohypothecs in different Member States may secure one or more claims (credit agreements) at the same time through a single security agreement (transnational Eurohypothecs).

Scope of the Eurohypothec: The scope of the Eurohypothec is the same as for other land charges under national law, insofar as they cover the property and the fruits and profits of the property, in particular rents, appurtenances and also claims under insurance contracts for losses to the property, buildings and specified items[9].

3.6. Holder

Owner's Eurohypothec: National law may provide that the Eurohypothec can also be created in favour of the present owner himself. Then the owner stays holder of the Eurohypothec even after ownership of the land changes.

Register Representative: All natural persons and/or legal entities may hold a Eurohypothec. In the case of the creation or transfer of a Eurohypothec in favour of a legal entity with no legal personality (e.g. in the form of a trust or some other fiduciary capacity), the national law may require that the registration be valid only where there is registration of a register representative who will give full information and who is entitled to make any declaration on behalf the actual ownership of the Eurohypothec.

4. Security Agreement

4.1. Definitions and applicable law

"Security agreement" means a contractual agreement under which the owner provides a Eurohypothec by way of security in favour of the (future) holder of the Eurohypothec.

"Secured claim" means the obligations which are secured by a Security Agreement and which give rise to a right to cash settlement. They may consist of or include:

- present or future, actual, contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);
- obligations owed to the future holder of the Eurohypothec by a person other than the collateral provider; or
- obligations of a specified class or kind arising from time to time.

[9] Some members would prefer harmonisation of the scope of the Eurohypothec.

The Eurohypothec can be used to secure cross-border loans but also, depending on the wishes of the parties, loans that only affect one country.

The security agreement is not subject to legal provisions for loan contracts. The applicable substantive law for the security agreement is the law of the Member State where the property is located (lex rei sitae)[10].

4.2. Form and Content

Any acquisition of a Eurohypothec as security, by a person other than the owner of the charged property, requires a security agreement.

Form

The security agreement must take the form required by national law. Oral agreements are invalid.

The owner is entitled to obtain a written copy of the security agreement. However, it does not have to be entered in the land register.

Minimum Provisions

A Security Agreement must contain the following minimum provisions:

- the names of the parties and the date of agreement,
- the Eurohypothec; it is possible to use one security agreement for several created Eurohypothecs or for multi-parcel Eurohypothecs,
- the claims to be secured,
- the conditions for redemption of the Eurohypothec by the security provider,
- the conditions of the enforcement procedure of the Eurohypothec, within the limits of the laws of the jurisdictions concerned.

Forbidden Clauses

The security agreement may not stipulate the following:

- restrictions on the sale of the property as a whole,
- a clause of voie parée[11].

Without the consent of the holder of the Eurohypothec in the form foreseen by the national law, the owner of the charged property may not create any charges on the property which could affect the Eurohypothec. This does not apply to charges inferior in rank.

4.3. Redemption and Owner's Rights

If there is no valid security agreement or if all secured claims have been repaid, the security provider has the right to demand redemption of the Eurohypothec or parts of it.

[10] Some members would prefer free choice of the applicable law for security agreements, in particular where commercial real estate loans are concerned.
[11] forfeiture clause

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He has the right to decide the means of redemption, whether it be extinguishment, transfer of the Eurohypothec to the security provider, or at his discretion to a third party. The holder of the Eurohypothec must contribute therefore, if necessary, at his own expense.

The security provider is allowed to assign the right to redemption to a third party.

In the case of a certificated Eurohypothec, the right to redemption includes the right to receive the certificate.

In the case of over-collateralisation, the security provider may, at his own expense, ask for partial adaptation of the collateral by reducing the amount of the Eurohypothec or via partial redemption.

In the event of enforcement, the holder of the different Eurohypothecs may be entitled under the security agreement to choose over which properties he wishes to carry out enforcement. As regards individual properties, the enforcement proceedings may be carried out separately or jointly[12].

If the holder of the Eurohypothec breaks the security agreement, the owner of the land is entitled to compensation for the damage suffered under the lex rei sitae. National law must provide effective compensation.

5. Transfer

5.1. Non-Certificated Right

The assignment of a non-certificated right is opposable to third parties only upon registration.

Registration of the assignment requires the consent of the previously registered owner of the Eurohypothec. National law may require an agreement between the previous and the new owner of the Eurohypothec as a substantive requirement for the assignment of the Eurohypothec.

5.2. Certificated Right

The assignment of a certificated right is governed by the law of the state where the land is situated.

The assignment is effective only if the Eurohypothec certificate has been handed over to the new holder of the Eurohypothec.

5.3. Formal Requirements

Formal requirements as to the parties' declarations of assignment, registration and transfer of the certificate must be the same as for other mortgages under national law.

[12] Some members propose that a joint procedure should follow the same rules in all Member States.

5.4. Good Faith

Whoever, according to national law, acquires in good faith, is protected,

- as if the registered person were the true mortgagee,
- in case of a certificated right also, as if the holder of the certificated right were the true holder of the Eurohypothec, provided he can prove his right by an unbroken chain of assignments in authentic instruments.

This does not affect the owner's objections (5.6.).

5.5. Independence of Secured Claim

The transfer of the Eurohypothec cannot be made dependent on the condition of transfer of the secured claim.

5.6. Owner's Objections

National law may provide

- either that the security agreement in its latest version is binding for any future holder of the Eurohypothec and any third party as long as the security provider is not the holder of the Eurohypothec.
- or, alternatively, that the previous Eurohypothec holder is liable for all damages incurred by the owner, if he assigns the Eurohypothec without binding the assignee to the security agreement.

If the holder of the Eurohypothec transfers it to a third party, the holder must inform the third party about the security agreement. If there is no further agreement, the holder can fulfil this obligation by handing over the original documents to the third party.

The owner's rights to redemption are not subject to any time limitation or prescription as long as the Eurohypothec is registered.

6. Extinguishment

6.1. Cancellation in the Register

The Eurohypothec is extinguished when it is deleted from the national competent register with the consent of the holder of the Eurohypothec and the owner. The Eurohypothec is not extinguished by the payment of the secured claims.

6.2. Passage of Time

The capital of the Eurohypothec is not subject to any time limit or prescription[13].

6.3. Owner's Rights under the Security Agreement

If the secured claims have been paid in full, the owner can demand cancellation of the Eurohypothec or its assignment to himself or to some other person of his choice.

[13] However, if the Eurohypothec yields interest, prescriptions or other time limits may apply to the interest.

The security agreement may state other cases in which the owner can demand cancellation or assignment of the Eurohypothec.

6.4. Exclusion of Unknown Holder

In the case where the holder of a Eurohypothec is permanently unknown or unattainable, or where the Eurohypothec certificate has been lost, the process foreseen under national law to cancel real charges will be applied.

B.III. Legal Environment for the Eurohypothec

7. Registration

The Eurohypothec can thrive only in a legal environment where ownership and all charges on land, and their respective ranks, are transparent in a register kept by the competent national authority (land register), which meets the following standards:

7.1. Contents of Registration

Land registers provide information on all transferable properties.

All real estate charges and other encumbrances on land, regardless of their nature, in particular also charges created by operation of law or by judicial decree, must be registered in the land register competent under national law in order to take effect against third parties (opposability)[14].

Registers must give a clear picture of the rights over property and their ranking. It must be transparent and comprehensible, without requiring additional research of documents in or outside the register (research on the exact contents of some rights may, on the other hand, be necessary).

7.2. Rank

Registration or Application: According to national law, the priority and rank of charges over land may depend either on the time of registration or on the time when the application for the registration was received.

In the second scenario, the Member State has to ensure that registration follows the priority of filing and that good faith in the registered rank is protected.

In enforcement and insolvency procedures, rights are satisfied from the proceeds in the order of their ranking in the land register.

Only those rights not entered in the land register, constituted by statutory provisions, which are property-related, limited in time and calculable, can rank prior to the Eurohypothec.

[14] National law may further require registration for the creation or transfer of real rights (constitutive effect).

7.3. Access

The information in the register must be accessible to anyone, in any Member State of the European Union, who might have an interest in it (e.g. by an electronic register).

7.4. Reliability

Confidence in register information must be protected and compensation provided in case of incorrect information.

7.5. Electronic Certificates

Member States may introduce electronic Eurohypothec certificates which are transferred by electronic systems. This does not affect the need for electronic authentification.

8. Enforcement

The quality of a security right over real property is dependent upon the effectiveness of enforcement. Hence, must be an effective procedure for enforcement, which meets the following standards.

8.1. Time for Enforcements Procedures

Enforcement of the Eurohypothec should be organised and regulated in all Member States in such a way that even if the owner and/or the debtor use all legal remedies within the normal procedure and if all time limits are fully exploited the enforcement can be accomplished and the monies obtained in enforcement paid out to the holder of the Eurohypothec within twelve months of the petition for enforcement. Member States should control whether this is in fact the case and take the necessary steps to achieve effectiveness of procedures.

8.2. Burden of Proof

The holder of the Eurohypothec must be able to commence and carry through enforcement proceedings without having to demonstrate the details of the loan and the legal relationships to a court and without proof of the debt, but merely based on the evidence of his holding the Eurohypothec itself.

The procedure must provide possibilities for the owner to object via pleas and defences arising from the loan contract or the security agreement in a formal legal procedure. If the owner disputes the amount or existence of the debt, the onus of proof lies with the Eurohypothec holder.

8.3. Judicial Appeal

The enforcement proceedings shall be carried out by a judicial body or shall include the possibility to appeal to a judicial body.

8.4. Prior Rights and Right of Replacement

In enforcement, all rights ranking prior to the petitioning creditor must be protected: The regulation may either foresee that the proceeds achieved from the sale price must, at a minimum, fulfil all rights ranking prior to the petitioning creditor, or it may foresee, that those rights remain in existence. In both cases, equal ranking and subsequent ranking rights as well as the right of the petitioning creditor itself are extinguished by enforcement. The extinguished rights are satisfied from the proceeds in the order of their ranking.

The right to replace the creditor petitioning for sale/auction should be granted to each creditor who would suffer loss of a right through sale or auction. Replacement takes place by means of payment to the Eurohypothec holder petitioning for the sale/auction. The replacing creditor pays the amount on account of which the sale or auction is being petitioned for. For the Eurohypothec, which is independent of the debt secured, this means that the replacing creditor does not pay on the secured claim but rather on the security right itself. Therefore the replacement only brings about the transmission of the security right itself to the replacing creditors. The secured claim does not pass over, but rather remains with the replaced creditor. The latter is obliged in accordance with the security agreement to credit the repayment sum to the debtor's account and set it off against the secured claim.

8.5. Owner's Personal Obligation

National law should provide for the possibility that, together with the Eurohypothec, the owner may create a title enforceable against himself personally. Where no agreement has been reached to the contrary, the creditor may not enforce double payment of the two titles, but in total may only enforce payment of (or up to) the sum of the Eurohypothec.

8.6. Applicable Law

Enforcement is governed by the lex fori.

9. Insolvency proceedings

9.1. No Deterioration of Rank

The Eurohypothec must give the holder the possibility of full satisfaction even in the event of insolvency of the owner. The order of ranking must not be changed in enforcement proceedings to the detriment of the Eurohypothec, with the exception of the expenses of the insolvency administrator related to the property which may be accorded a higher rank.

9.2. Separate Enforcement (segregation)

In the case of insolvency of the owner, the enforcement of the Eurohypothec should not await the realisation of other assets, but should be treated separately from the

insolvency estate. Enforcement proceedings should not be interrupted or stopped by the commencement of insolvency procedures. In an insolvency, a Eurohypothec holder must have the possibility of commencing enforcement of the Eurohypothec, either by enforcement proceedings separate from the insolvency procedures or by sale at the hands of the insolvency administrator. The execution of enforcement in these cases can only be postponed by decision of a judicial body or controlled by a judicial body, and only in order to ensure the operations of the insolvency estate. This postponement shall be for a limited time period only and in no case shall it exceed one year.

10. Costs and State Taxes

State earned taxes and fees must be the same as for other real estate charges (mortgages) under national law. Differences in fiscal treatment between local and foreign lenders are contrary to European law.

To avoid double taxation in various Member States, Member States are to collect State-earned taxes on the collateral creation process and not on the credit contract. The Member States should collect State-earned taxes based only on the amount of the secured (registered) sum, and not on more than the maximum fiscal value of the secured good. Security agreements should not be subject to any state earned fees or taxes.

B.IV. Implementation

11. Implementation

The Eurohypothec may be introduced by regulation as a 26th regime, existing alongside the national real estate charges (which would continue to exist). Alternatively, it may be introduced by directive, to be implemented either by adapting an existing instrument or by creating a new type of mortgage under national law.

Only real estates charges meeting the requirements of the European instrument may be called Eurohypothecs.

C. Complementary working papers on Eurohypothec

Additionally to the Basic Guidelines, the workshop has adopted 4 working papers by members of the workshop showing major aspects of the Eurohypothec.

The charts on business structures deal with principal business cases in real estate financing and the ability of non-accessory real estate charges to serve these cases in a more flexible manner, as compared to traditional mortgages. (C-1)

The contribution on accessoriness illustrates the legal basics of the relation between the real estate charges and the secured claims. (C-2)

In Poland, the introduction of non-accessory real estate charges is under parliamentary discussion. Their experiences are therefore of particular interest for this project. (C-3)

The last article shows the options EU law provides for the implementation of the Eurohypothec. (C-4)

C.1. Charts on business structures

ANDREAS LUCKOW
Association of German Mortgage Banks, GERMANY

I) General Objectives of the Eurohypothec (1-4)

1) Cross Border Lending
2) Free Transfer of Mortgages
3) One Mortgage for a Pool of Properties
4) Flexibility of the collateral

II) Business Cases

1) one loan - one property - one owner - one bank

2) Changes in the loan
   2.1 "Sectioned Loans", different terms of fixed or floating interest
   2.2 Flexible loan
   2.3 New agreements on the loan
   2.4 New loan
   2.5 Additional loan
   2.6 Interim Finance, Construction Finance

3) Different Banks
   3.1 New loan, new bank
   3.2 Interim finance, Specialised bank
   3.3 Additional loan, Another bank

4) Exchange of the bank, Transfer of the loan and the mortgage,
   4.1 Sale of the loan
   4.2 Partial sale of the loan - syndication

5) Replacement of the borrower
   5.1 Conversion of debt
   5.2 Sale of the property
   5.3 Sale of the property, new loan
   5.4 Developments
   5.5 Forced Sale

6) Replacement of the Property

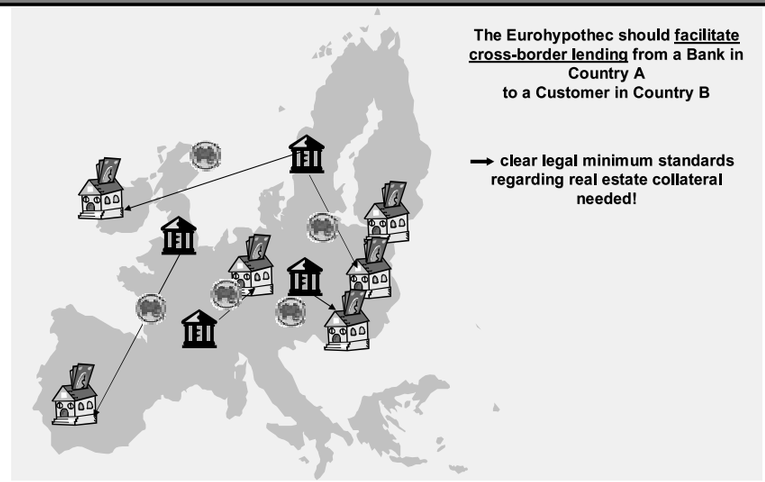
7) Joint Mortgage

source: Verband deutscher Hypothekenbanken

MORTGAGE CREDIT FOUNDATION

MORTGAGE BULLETIN 21/2005

I) General Objectives of the Eurohypothec (1)



source: Verband deutscher Hypothekenbanken

1) Cross Border Lending

Different standards of mortgages and hypothecs in different countries make it difficult for a lender to assess how far a mortgage covers his risk.

Lenders need:

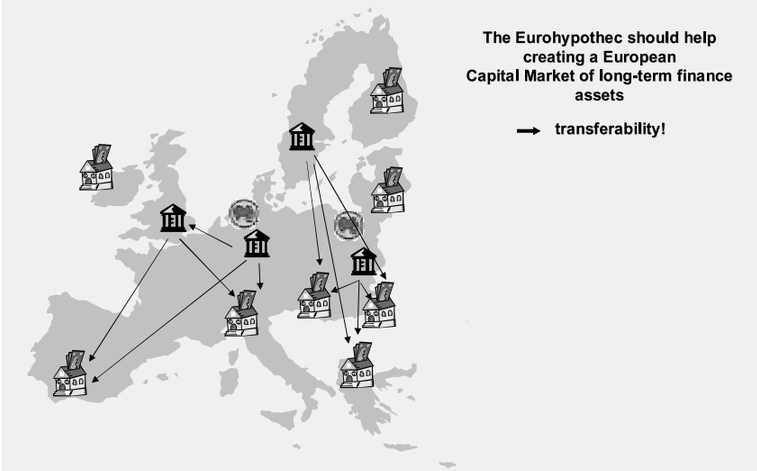
- either specialists and special expertise for each country and each jurisdiction
  - a bank can build up such an organisation only for a few countries
- or legal opinions and expert help in that country
  - this is too expensive for consumer lending

As a result, cross border finance for consumers and owner occupied housing is almost inexistent.

A clear minimum standard, set by a Eurohypothec, can change that situation.

source: Verband deutscher Hypothekenbanken

I) General Objectives of the Eurohypothec (2)



source: Verband deutscher Hypothekenbanken

2) Free Transfer of Mortgages

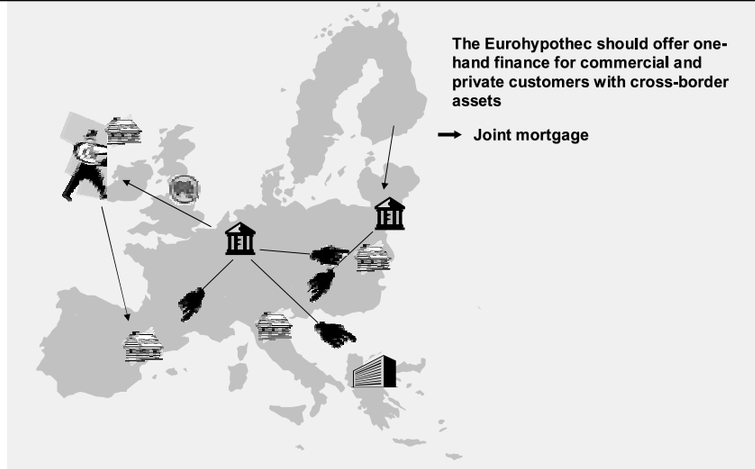
Still, most European banks keep a buy-and-hold-strategy with mortgages. For several reasons, it must be possible to transfer mortgage loans and hypothecs between banks and financial companies:

- Acquisition of loans in another country may be difficult. Loans could be acquired by local banks and passed to long-term financing banks.
- Banks could specialise to their best fields:
  - acquisition
  - long term funding
  - special forms of loans
- Transfer of mortgage loans and hypothecs can be used to create MBS structures or lending via covered bonds.
- This should be possible cross-border, to create and transfer nationally mixed, risk-diverse portfolios
- So, a European Capital Market of long term assets can emerge.

For this, a mortgage loan and a hypothec must be freely transferable.

source: Verband deutscher Hypothekenbanken

I) General Objectives of the Eurohypothec (3)



source: Verband deutscher Hypothekenbanken

3) One Mortgage for a Pool of Properties

More and more companies and private people have real estate in different European countries.

If different properties in different countries could be secured for one loan by only one mortgage, risk would be diversified. As a result, the risk would be lower for the whole loan than for those traditional loans that could be financed today in different countries.

If customers could offer their banks one mortgage on different properties in different countries, they would have better and cheaper access to credit.

For this a hypothec must be possible on a pool of properties in different countries ("joint mortgage / hypothec").

Nationally different hypothecs cannot, only a Eurohypothec can provide this result.

source: Verband deutscher Hypothekenbanken

I) General Objectives of the Eurohypothec (4)

At the same time, the Eurohypothec should give as much flexibility as possible within each country and cross-border

For 1) different loans

2) different banks

3) different borrowers

source: Verband deutscher Hypothekenbanken

4) Flexibility of the collateral

A Eurohypothec should not be restricted to one or a few existing business models of mortgage credit, but give as much room as possible to different customs of the market and to future developments in a future European long term finance market.

It should allow the customer and the banks to use it for

- different loans of whatever mature and purpose
- different financers

and

- different customers or borrowers.

→ solution ° to regulate a special structure

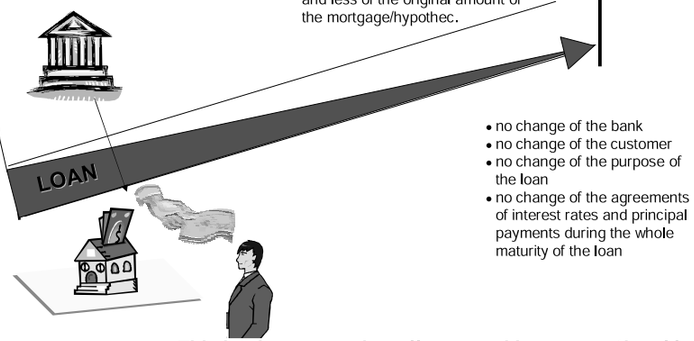
= to create a flexible collateral instrument as part of new finance structures

source: Verband deutscher Hypothekenbanken

II) Business Cases
1) one loan - one property - one owner - one bank

- mortgage established
- bank pays loan to the customers customers invest monies in property

The loan is paid back in annuities over time. The loan covers less and less of the original amount of the mortgage/hypothec.



- no change of the bank
- no change of the customer
- no change of the purpose of the loan
- no change of the agreements of interest rates and principal payments during the whole maturity of the loan

This business case is well arranged in every national law!
But it is becoming the exception.

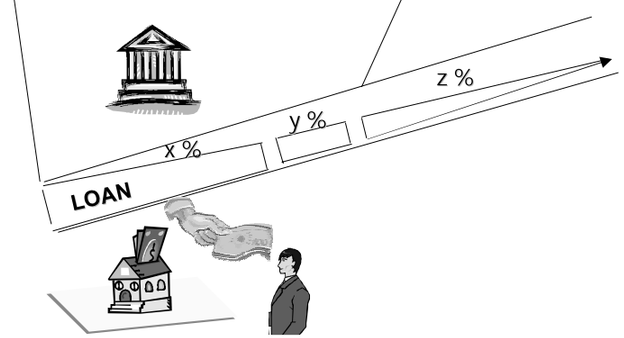
source: Verband deutscher Hypothekenbanken

2) Changes in the loan. 2.1 “Sectioned Loans”, different terms of fixed or floating interest

- mortgage established
- bank pays loan to the customers
- interest rate fixed for several years

loan paid back in annuities

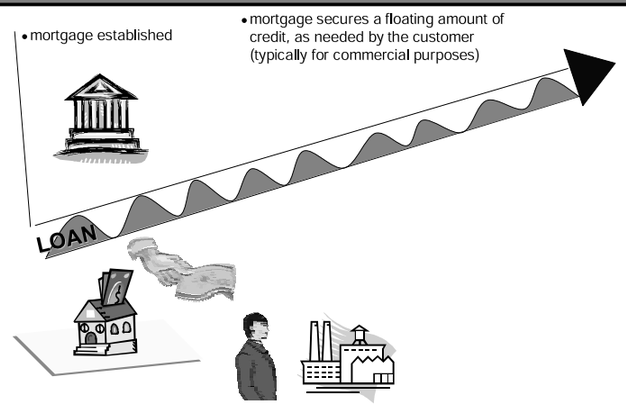
- new agreements on interest rate (fixed of floating) and/or principal payments



All covered by the original accessory hypothec?
Novation of the loan claim secured by hypothec?

source: Verband deutscher Hypothekenbanken

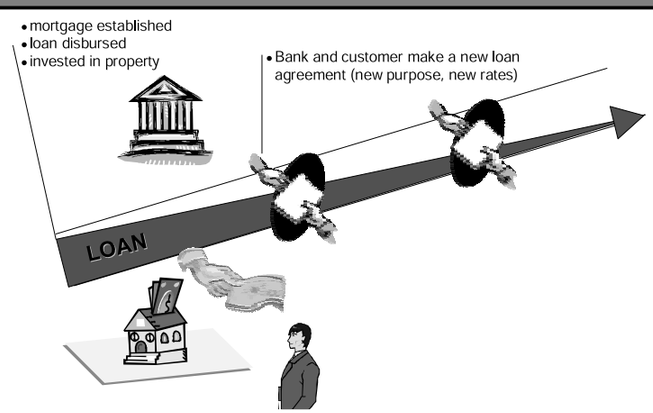
2.2 Flexible loan



Secured by an accessory hypothec? **(many countries have special forms of hypothec with limited accessoriness for this case)**

source: Verband deutscher Hypothekenbanken

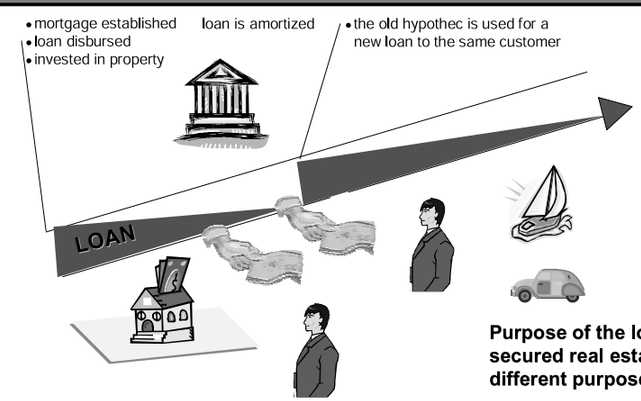
2.3



Is the 2nd loan still covered by the same accessory hypothec?

source: Verband deutscher Hypothekenbanken

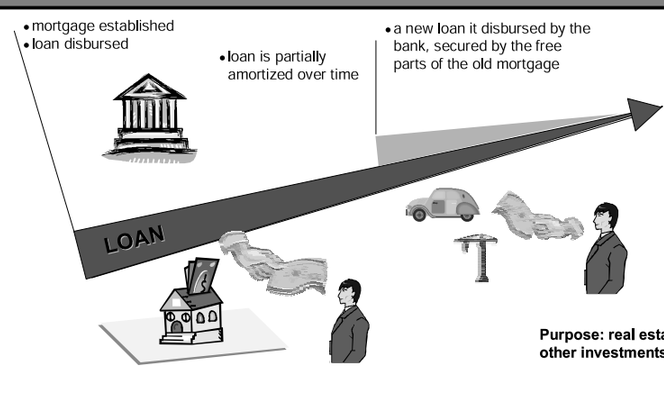
2.4 New loan



Covered by the old mortgage?

source: Verband deutscher Hypothekenbanken

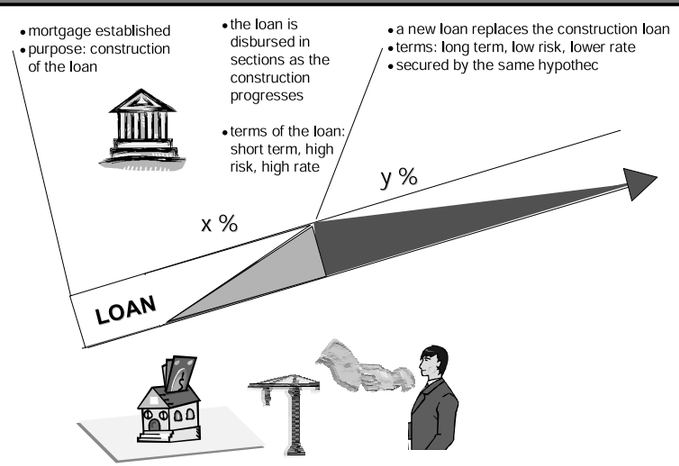
2.5 Additional loan



Covered by the original mortgage?
Some countries have special forms for that.

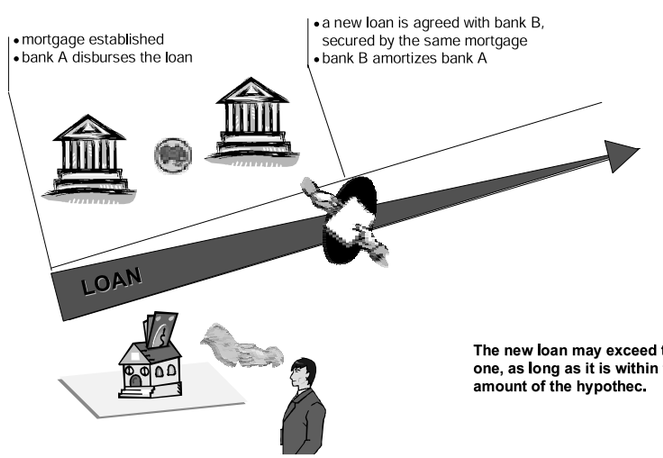
source: Verband deutscher Hypothekenbanken

2.6 Interim Finance, Construction Finance



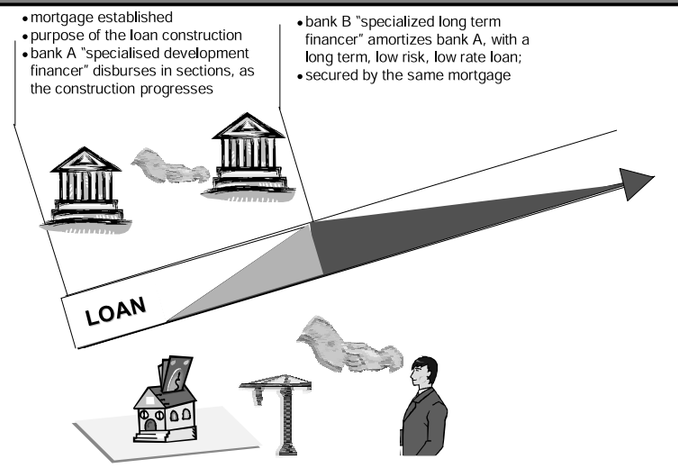
source: Verband deutscher Hypothekenbanken

3.Different Banks
3.1 New loan, new bank



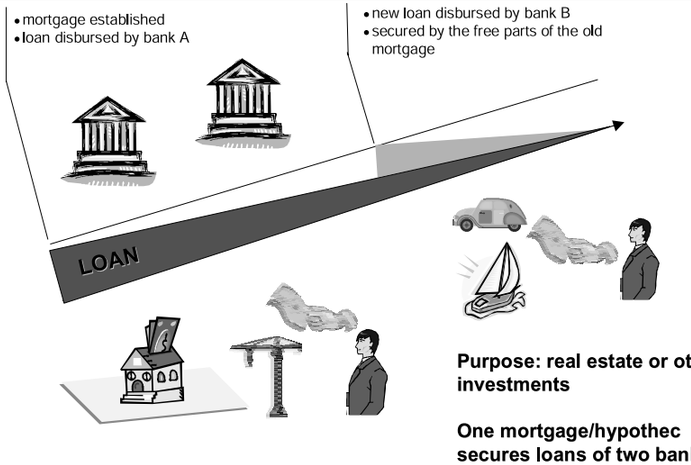
source: Verband deutscher Hypothekenbanken

3.2 Interim finance. Specialised bank



source: Verband deutscher Hypothekenbanken

3.3 Additional loan. Another bank



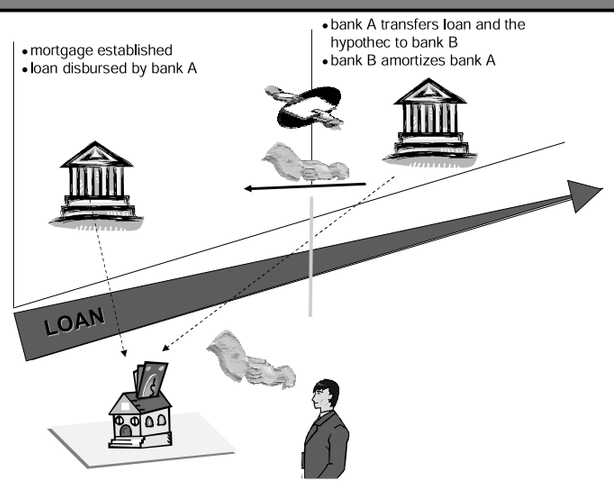
source: Verband deutscher Hypothekenbanken

4. Exchange of the bank. Transfer of the loan and the mortgage.

Purpose:
- risk and equity allocation in groups
- portfolio control, risk control
- creation of nationally mixed risk diverse loan portfolios
- funding by who can fund best (MBS, Covered bonds)

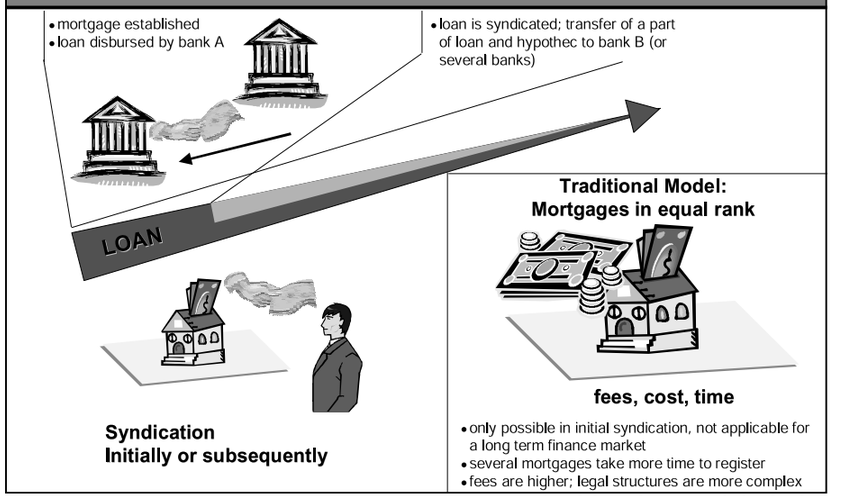
source: Verband deutscher Hypothekenbanken

4.1 Sale of the loan



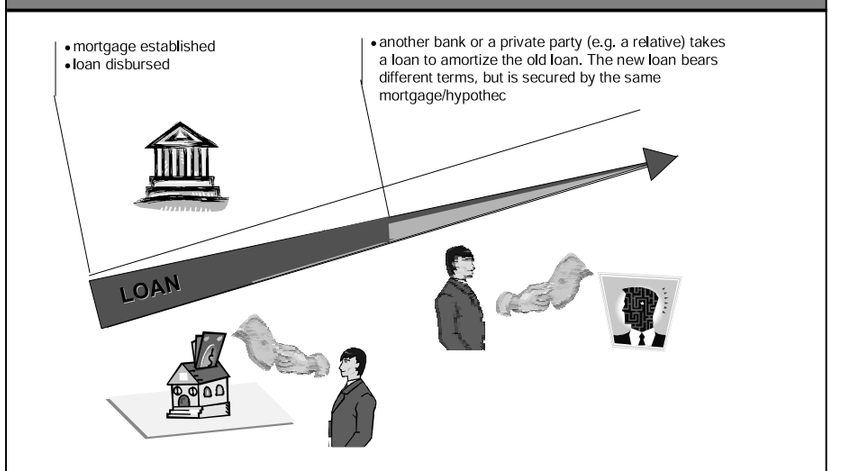
source: Verband deutscher Hypothekenbanken

4.2 Partial sale of the loan Syndication



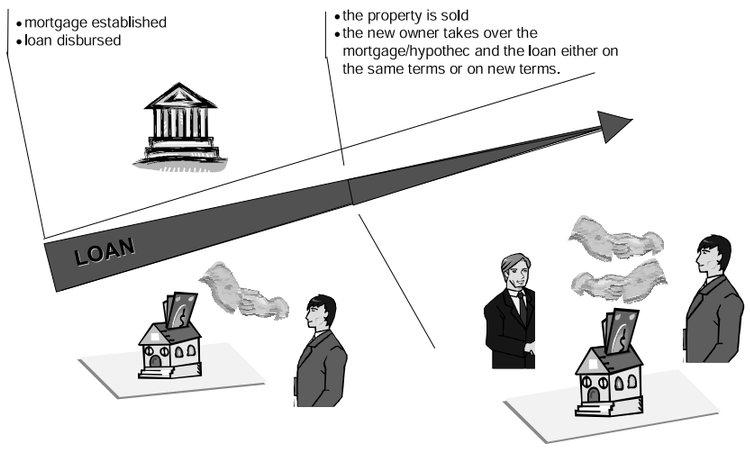
source: Verband deutscher Hypothekenbanken

5. Replacement of the borrower 5.1 Conversion of debt



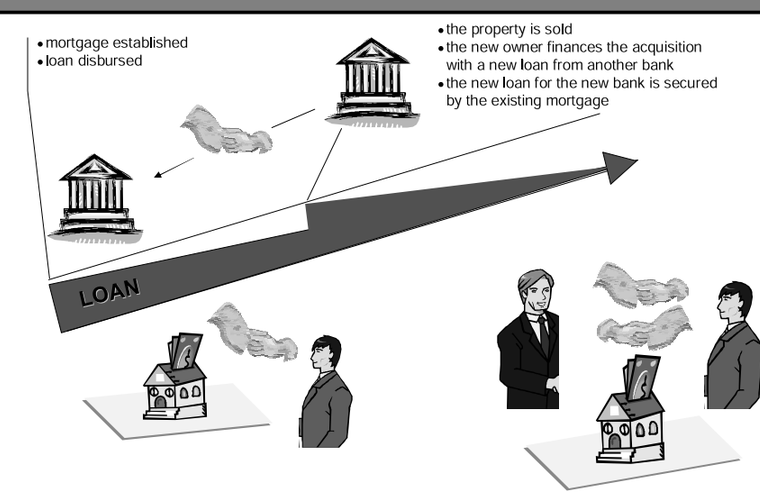
source: Verband deutscher Hypothekenbanken

5.2 Sale of the property



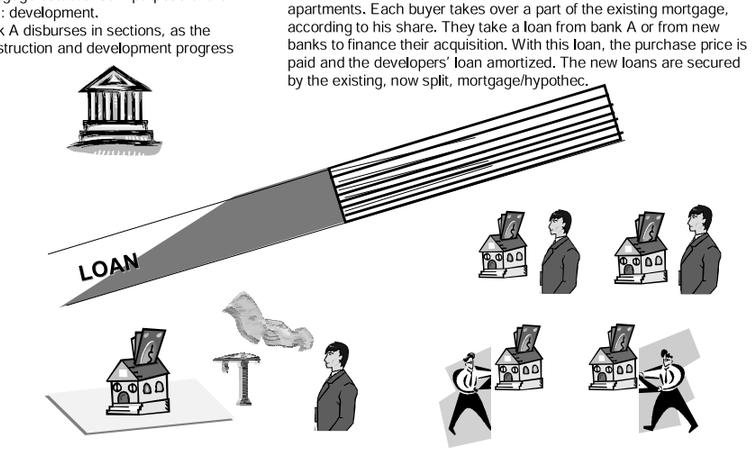
source: Verband deutscher Hypothekenbanken

5.3 Sale of the property



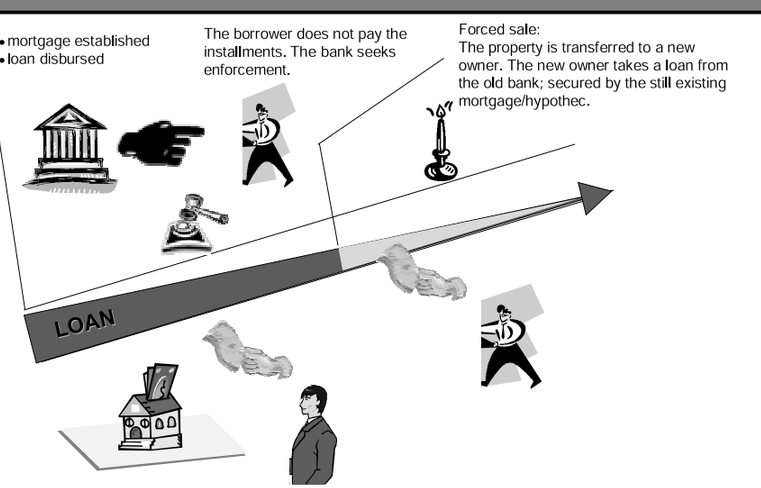
source: Verband deutscher Hypothekenbanken

5.4 Developments

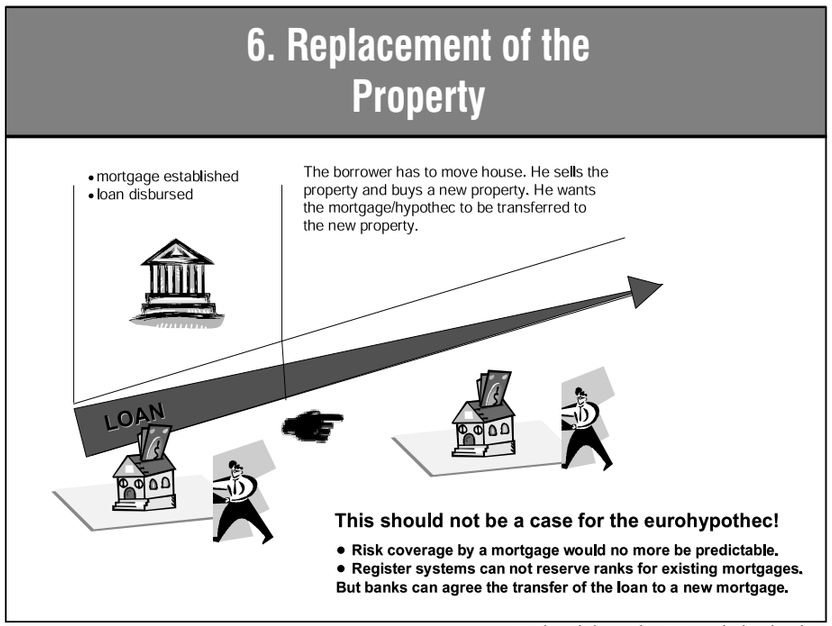


source: Verband deutscher Hypothekenbanken

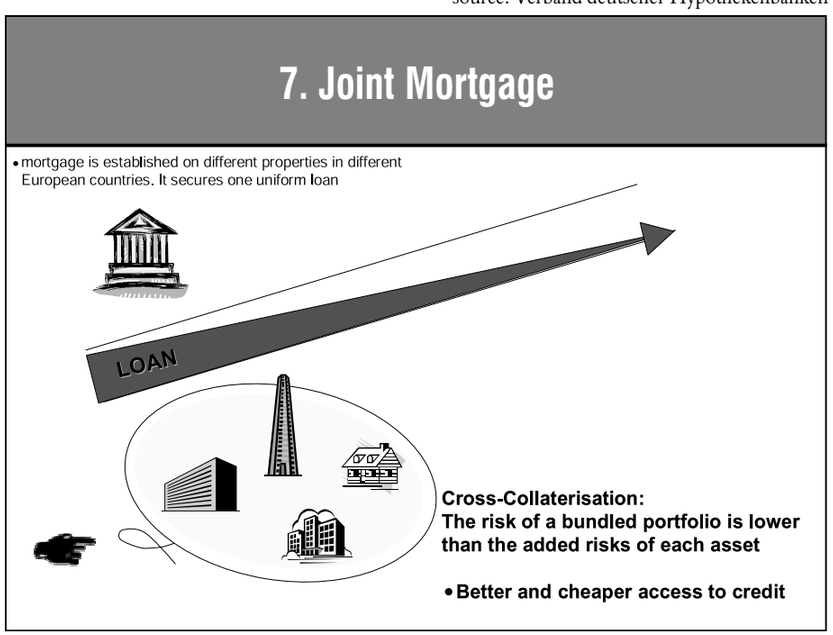
5.5 Forced Sale



source: Verband deutscher Hypothekenbanken



source: Verband deutscher Hypothekenbanken



source: Verband deutscher Hypothekenbanken

MORTGAGE BULLETIN 21/2005

C-2. The Eurohypothec - Accessoriness as legal dogma?

DR. OTMAR STÖCKER
Association of German Mortgage Banks, GERMANY

I. Research work and debate

The introduction of a uniform law on security rights over real property is a topic that has been mooted in Europe for 40 years, the aim being to facilitate cross-border lending operations and foster an internal market in mortgage lending.

Having been described as a political necessity in the so-called Segré report[15] relating to the introduction of a flexible non-accessory security right, the UINL[16] proposal attracted a great deal of attention in suggesting that the Swiss certificate of indebtedness (*Schuldbrief*) should be taken as the model for a Eurohypothec to achieve a versatile non-accessory security right. It was proposed that

- along with the existing security rights over real property in the individual Member States (such as mortgages, land charges etc), a pan-European mortgage uniformly introduced in all Member States should be made available to lending institutions;

[15] In the autumn of 1966 a group of experts appointed by the EEC Commission and headed by Prof. Claudio Segré - then Head of Research at the EEC Commission Directorate-General for Economic and Financial Affairs - submitted an extensive report on "The Development of a European Capital Market". The experts' task was to carry out a comprehensive investigation of the problems arising from the liberalisation of movements of capital and the implications of the integration of capital markets. The most significant structural differences in the individual capital markets were portrayed and capital flows within the EEC indicated. The "Segré Report" came to the following conclusion (p. 177): "An approximation or harmonisation of the laws on security rights within the individual Member States should be considered a priority. The land charge described in the previous chapter could play a vital role in funding house building as it is more adaptable and cheaper than the hypothec. It would also be appropriate to allow mortgages and land charge entries to be made in a currency other than the national currency." Another conclusion is also reached (p. 165): "The introduction of a mortgage common to all Member States would help to integrate capital markets. The German Grundschuld could be suggested here, a very adaptable means of providing security." On these proposals in the Segré Report, see Kircher, Grundpfandrechte in Europa, p. 418 et seq. and p. 442 et seq.; Stöcker, Die Eurohypothec, p. 216 et seq.

[16] The Union Internationale du Notariat Latin (International Union of Latin Notaries, "UINL") has put forward observations on how the considerable barrier resulting in practice from the differences in civil law in the Member States of the EC, particularly mortgage law, could at least be lowered, if not completely overcome. The UINL Commission for European Affairs (CACE) therefore set up a "Eurohypothec" subcommittee to (1) produce a comparative law review of the Swiss Schuldbrief and the German Briefgrundschuld; (2) contrast the results of this legal comparison with the legislation in the EC States and (3) on that basis to draw up suggestions for future common legislation on a security right over real property with a marketable title. As a result of the work carried out by this "Eurohypothec" subcommittee the UINL/CACE submitted its proposal for the introduction of a "Eurohypothec" to the EC Council of Ministers on 22.5.1987.
Re. this proposal by the UINL see in particular Wehrens, ÖnotZ 1988, pp. 181 - 191; Wehrens, WM 1992, pp. 557 - 563; Wehrens, Real Security Regarding Immovable Objects - Reflection on a Euro-Mortgage, in: Towards a European Civil Code, The Hague/London/Boston 1998, pp. 551 - 564; Kircher, Grundpfandrechte in Europa, pp. 481 - 506; Stöcker, Die Eurohypothek, pp. 228 et seq.

- this uniformly regulated security right over real property should be structured largely on the example of the Swiss certificate of indebtedness (*Schuldbrief*);
- lending institutions and borrowers within the EC would thereby be offered a more marketable and versatile security right over real property as an alternative to the existing security rights over real property in each Member State; and
- in this way any legal, economic and practical disadvantages of conventional strictly accessory mortgage would be avoided.

This issue has attracted particular interest not least of all due to the fact that the Forum Group created by the EU Commission has dealt with the proposal to introduce a Eurohypothec, considered it positive[17] and put it into its list of recommendations.

However, less attention has been paid to the fact that a number of academics have for some time been concentrating directly on the Eurohypothec issue:

- In 1998 the Association of German Mortgage Banks (VDH), with the help of a team of experts from both academic and practical backgrounds, developed guidelines for a flexible non-accessory security right which were then incorporated in its proposed legislation; this has now provided the foundation for consultancy work carried out by VDH in central and eastern European countries involved in reforms and the development of a modern law on security for loans.[18]
- These guidelines were further developed by the pan-European group of experts initiated in Spain, known as "The Eurohypothec".
- The new guidelines were also taken into account by the "Collateral" Sub-Committee of the Forum Group, which incorporated the principles in its recommendations.

At the same time, other expert bodies have also been examining the law of real property in Europe, of which security rights also form part:

- The European University Institute (EUI) in Florence, in association with specialists from almost all EU States, is currently undertaking a comparison of property law in EU countries. This also includes security rights, so that important preliminary work on a Eurohypothec is also being done here. A comparative report is to be published in 2005.

[17] EC, Report, p. 30, Rdnr. 117 "The Forum Group considered the Euromortgage to be an alternative tool which could be introduced by Member States, without substantial changes to their existing legal systems, as it would operate under the rule of lex rei sitae. Such a pan-European non-accessory mortgage instrument could
· Avoid burdensome and costly inquiries in other Member States concerning local regulations and the quality of the national mortgage instrument;
· Reduce additional and differing formalities and authentication;
· Offer mortgage collateral as security for more than one mortgage credit;
· Enable easy transfer of the mortgage as well as the property;
· Meet the requirements for cross-collateralisation on a cross-border basis;
· Meet the requirements for securitisation and mortgage portfolio management; and
· Enable the creation of bank syndicates for mortgage finance."

[18] Wolfsteiner/Stöcker, A Non-Accessory Security Right over Real Property for Central Europe - published in Notarius International 2003, pp. 116 - 124.

- A number of academics and practitioners have combined to form the so-called "Trento Group". Their aim is to examine topics relating to the harmonisation of civil law of relevance in practice.[19]
- The importance of the endeavours made by the EU Commission to draw up a common framework of reference for a European law of contract should not be underestimated in this context.[20] Although this framework of reference is intended to concentrate on contract law, a number of fundamental issues will undoubtedly also arise, particularly in relation to causality and accessoriness, and these will therefore also have consequences in relation to security rights over real property.
- Even specialist publications have as yet paid little attention to the pioneering work undertaken by the "European Union Land Information System" project (EULIS).[21] This was initiated by land registry bodies in northern European countries. Eight European countries are now involved in it.[22] The aim of the project is to create a common Internet portal for European land registers and records. With this aim in mind, groups across Europe are not only systematically examining and comparing national land register and recording systems but are also conducting an in-depth comparative-law review of the rights registered - including security rights over real property.

The Association of German Mortgage Banks has initiated a number of these projects and is collaborating directly or indirectly on all of them. Its main objective is to promote the academic exchange of views amongst specialists on the various projects to achieve an efficient and comprehensive review of this whole topic.

One thing that all these initiatives have in common is the fact that, if the Eurohypothec security instrument is to apply within all different kinds of legal systems it will be necessary to carefully analyse the fundamental principles relevant to security rights to achieve full integration of the Eurohypothec within the national legal systems concerned.

[19] More about this on the "Trento Group" website: http://www.jus.unitn.it/dsg/common-core: "Stating it in very simple terms, we are seeking to unearth the common core of the bulk of European private law, i.e., of what is already common, if anything, among the different legal systems of European Union Member States. Such systems are differentiated not only by the civil law and the common law heritage, but also by a number of other Western legal traditions (or sub-traditions), according to the taxonomy one wishes to adopt. These differences impede our task, particularly if the perspective encompasses procedure and legal institutions where the divergence of legal tradition may be even more important. Consequently, we decided to limit our search to private law, within the general categories of contracts, torts, and property."

[20] Of particular importance is the preparatory work done by the "Study Group on a European Civil Code", headed by Prof. Christian von Bar of the University of Osnabrück; see the website http://www.sgecc.net.

[21] Ploeger/van Loenen, p. 379: "An increase in cross-border transactions of real estate within the European Union demands for easy access to the information of the national land registries of the Member States. The EULIS project brings together the registrations of eight European countries in one portal. Thus it provides access to cross-border information about the rights on real estate, using the information in the computerized databases of the participating organizations. The EULIS project is the first step towards a more transparent system of real estate transactions in Europe. The next logical step, from the viewpoint of international accessibility of the information, is the harmonization or even integration of the national land registries within Europe in one European land registry." Cf. also the EULIS website: "www.eulis.org". Cf. also Zevenbergen, Notarius International 1-2/2003, pp. 125 (136 et seq.).

[22] Ploeger/van Loenen, p. 382: "EULIS is a project within the eContent programme of the Directorate-General Information Society of the EU. It is collaboration between the organizations that provide computerized access to the legal information on real estate of eight European jurisdictions: Austria, England and Wales, Finland, Lithuania, the Netherlands, Norway, Scotland and Sweden. Also, Lund University is involved in the project."

The idea of a Eurohypothec is often the subject of considerable doctrinal criticism. For example, if it is to exist in the form of an "abstract" security right - it would not observe the "causality principle" of Roman law-based systems and would also present some risks to owners.

There are two doctrinal issues that arise in relation to such criticisms:

1. Does a non-accessory security right observe the causality principle, particularly of systems based on Roman law? - Answer: yes.

2. Can the same level of protection be afforded to an owner with a non-accessory security right as to an owner with an accessory hypothec? - Answer: yes.

Both of these questions and their answers will be briefly discussed below. The purpose of this paper is to shed light on these two topics that are commonly portrayed as legal dogma. However, the doctrinal issues will not be academically discussed in depth, as this has already been done elsewhere.

II. Causality and accessoriness

The civil-law doctrine of virtually all European legal systems differentiates (at least at a theoretical level) between

- the obligation element (the obligation to create a security right) from which claims arise, and
- the performance element (the act of creating a security right) as a result of which claims are satisfied and legal classifications changed (transfer of title) or as a result of which rights are created (creation of security rights).

Some legal systems in Europe abide by the so-called **unity principle**, according to which the obligation and performance elements form a single legal act.[23]

Others adopt the **separation principle**. Here the obligation element (to create security) forms the "*causa*" for the act of creating the security (the performance element).

In the case of a sale the obligation element (*causa*) is the contract of sale, whilst the performance element is the *ad rem* agreement to transfer title to the item sold (and the money).

In the case of a security right the obligation element (*causa*) is the duty to create a security right (e.g. as collateral for a loan), whilst the creation of the security right (as an *ad rem* legal act) constitutes the performance element. This duty is normally regulated in the loan agreement. It is not correct, however, to regard the lender's claim for repayment of the loan as the "*causa*" of the security right.

[23] There cannot be any difference here between the absence of one element of a legal transaction and of other elements since the whole legal transaction is regarded as one unit. If the obligation element of the legal transaction is therefore missing (or if it subsequently lapses) then the performance element will also be non-existent as the two elements of a legal transaction cannot have different fates - at least if the unity principle is strictly applied and no exceptions are allowed.

Regarding the German (non accessory) "Grundschuld", it is often said that the "*causa*" is contained in the security agreement. However, this does not reflect normal lending practice in Germany.[24] Very different opinions are expressed in literature on this particular point. These might possibly be reconcilable in so far as a distinction is drawn between

- the loan agreement (that produces the claim to be secured)
- the security arrangement (that security has to be created, i.e. the "*causa*" for the security) and
- the security agreement (which governs the relationship between the security and the claim to be secured).

Banking law also advocates inclusion of the "security clause" in the credit agreement. It is virtually impossible to conceive of circumstances in practice in which a credit agreement would be concluded without the question of the creation of security also being determined in that agreement. It is absolutely vital - purely for risk weighting purposes (i.e. capital provision) - to link the security issue to the credit agreement so as to be able to decline to pay out the loan or so as to have a right of cancellation if the client does not create the security. This might well need to happen in practice - particularly if the level of security is not sufficient. The security is important to banks not only for economic reasons but also because of a whole number of provisions of banking law. The link must therefore be created - otherwise banks might possibly not be able to benefit from provisions governing lending against real estate collateral.[25]

1. Causality - "abstraction"[26]

Taking the separation principle as the basis, therefore, the question that arises is how the relationship between the obligation element and the performance element should be construed. It is particularly doubtful whether the performance element still exists if the obligation element (i.e. the "*causa*") is absent or lapses.

Those legal systems that abide by the **causality principle** say that the performance element lapses for lack of "*causa*". The performance element here is therefore immediately dependent on the obligation element (causality element).

Other countries apply the **abstraction principle**, according to which the performance element basically continues even without "*causa*" albeit with special rules governing reversal.[27]

[24] See Soergel/Stöcker, ZBB 2002, p. 412 (416). Contrast Stadler, p. 584 and further references which place the "*causa*" for the grant of a security right within the security agreement - and not in the loan agreement, although she also makes it clear that the claim secured does not constitute the "*causa*".

[25] On this topic of banking supervision, see in more detail Stöcker, Realkredit und Pfandbriefsicherheit, p. 4 et seq.

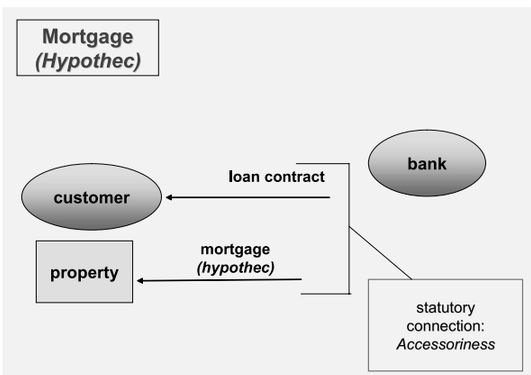
[26] Cf. in particular. Stadler, Gestaltungsfreiheit und Verkehrsschutz durch Abstraktion, pp. 7 et seq.; Baur/Stürner, Sachenrecht, § 5 IV., pp. 47 et seq.

[27] If the "*causa*" is absent from a German land charge, or if it later lapses, the party providing the security has a claim for unjustified enrichment because security is provided without any legal grounds (§ 812 (1) BGB); that claim - as the provider of the security may choose - is for reassignment, renunciation or rescission of the land charge; see in this respect Baur/Stürner, Sachenrecht, § 45 II. 2. p. 519; Stadler p. 582 et seq.

The question of causality/abstraction is ultimately a technical legal detail that does not prevent the introduction of a non-accessory security right in each of the individual EU States. Even a country that abides by the causality principle can accept non-accessory security rights; without "*causa*" there is just no security right. It is ultimately virtually all the same whether a security right lapses automatically for lack of "*causa*" or whether it has to be returned for lack of "*causa*". Practical instances of absence or lapse of "*causa*" should seldom occur in practice - such as, for example, in the event of circumstances giving rise to rescission or in the absence of consent or approval.[28]

2. Accessoriness[29]

"Accessoriness" is a completely different topic. Accessoriness is the term to define the degree or extend of linkage between the different elements of the mortgage arrangements, that is to say the creation of the loan and the creation of the security.



It is often stated as a fundamental legal principle (or dogma) that the protection of the borrower or owner cannot be secured without a strong linkage (accessoriness) between the loan and the security. Before looking more closely at the question of protection it is necessary to examine briefly the following questions:

a) What is the function of accessoriness?
b) What different types of accessoriness are there?

a) The function of accessoriness

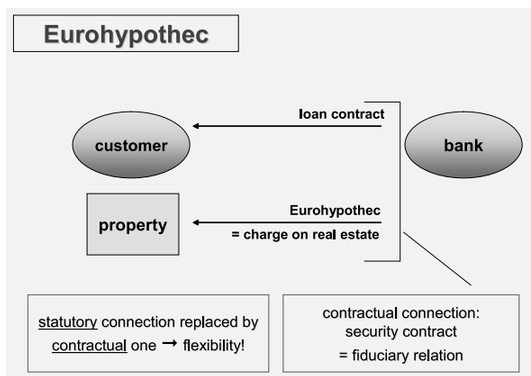
The purpose of accessoriness is to combine rights that have identical objectives. So, in the case of mortgages, the loan obliges the debtor to make payment and the hypothec

[28] In some legal systems, for example, the consent of a spouse will be necessary in order for a loan to be taken out. If that consent is not given the loan agreement will be invalid so that the "*causa*" will also be absent in relation to the provision of a security right. Banks know the legal position and in those cases therefore demand the consent of the spouse. There will be a problem if the customer lies to the bank and says that he or she is not married.
[29] Cf. in particular Medicus, Durchblick: Die Akzessorietät im Zivilrecht, JuS 1971, pp. 497-504. The distinction developed by Medicus between types of accessoriness is the subject of further examination at pp. 41 et seq.; also at Brockhuis, pp. 187 et seq.

is intended as security in the event that the debtor is unwilling or unable to make payment. The aims of the two instruments are the same and the principle of accessoriness is the means by which the two are combined.

Rights created by the principle of accessoriness, such as a hypothec, are subservient to the rights created by the main instrument (such as loan). To put it another way, rights created by the loan agreement have priority over any rights created by the security. The principal function of accessoriness is technical legal simplification: the legal system primarily determines the fate of the claim secured - and the same then also applies, via the accessoriness principle, to the hypothec. In none of the legal systems in Europe, however, is this absolutely the case with regard to the hypothec; exceptions to the accessoriness principle and deviations from it can be found everywhere.[30]

In the case of non-accessory security rights this connection between the claim secured and the security right is created by the security agreement. The security agreement therefore compensates for the lack of accessoriness,[31] but does not make the security right accessorial. A fiduciary relationship is created: the creditor undertakes in the security agreement to enforce its entitlement to the security only in certain circumstances.[32]



One important difference between accessory and non-accessory security rights concerns the question of divergence between the holder of the claim secured and the holder of the security right. Only in the case of a non-accessory security right does the holder of the security right not have to be one and the same person as the holder of the claim secured; in the case of an accessory security right they must be one and the same person. Hence: whenever the conduct of a transaction makes it necessary to separate the holder of the security right from the holder of the claim secured there can be no question of accessory security rights.[33]

[30] See, for example, the many forms of maximum-amount mortgages in Europe.
[31] Soergel/Stöcker, ZBB 2002, p. 412 (416).
[32] See Kircher, p. 58 et seq. and other references, particularly on the question of who is the party to the security agreement if the debtor and owner are not identical.
[33] Soergel/Stöcker, ZBB 2002, p. 412 (417).

b) Types of accessoriness

In a Eurohypothec context accessoriness is generally treated as a black and white issue: the Eurohypothec must be either strictly accessory or completely non-accessory. However, this ignores some other possibilities.

Types of accessoriness can be distinguished according to the circumstances relevant to adjustment of "secondary" rights to "primary" rights. These types or effects of accessoriness can be distinguished as follows:

(1) Accessoriness of origin: the security right only exists if the claim secured also exists.

(2) Accessoriness of scope: the scope of the security right is determined by the scope of the claim secured, e.g. by its amount.

(3) Accessoriness of competency: the holder of the claim secured is also entitled to the security right.

(4) Accessoriness of extinguishment: if the claim secured is extinguished (e.g. by redemption[34]) the security right is also extinguished.

(5) Accessoriness of enforcement: the security right is only capable of enforcement if the claim secured is also capable of enforcement.

This identification of primary rights (i.e. the claim secured) and secondary rights (i.e. the hypothec) cannot be determined by a simple yes or no answer. This is the most fundamental and most frequent mistake, regularly leading to lack of understanding and confrontation in discussions on the Eurohypothec.

Whilst accessoriness or non-accessoriness is postulated[35] in simplified terms as an absolute necessity, it is impossible (or at least more difficult) to develop a differentiating view of the different types or effects of accessoriness.[36]

It would be better to examine the individual effects of accessoriness in terms of what advantages and disadvantages they present to the parties involved. It would then be possible on that basis to develop recommendations on the accessoriness or non-accessoriness of a Eurohypothec.

[34] Repayment of the claim then leads to the extinguishing of the mortgage where the mortgage is "accessory in existence", such as, for example, in France. As a result of repayment, however, a subordinate case of accessoriness of competency can also be affected, such as, for example, in the case of the German *Hypothek* where the extinguishment of the claim leads to the owner acquiring the *Hypothek*, which is then converted into an owner's land charge (§ 1163 (1), sentence 2 and 1177 (1), sentence 1, BGB); the German *Hypothek* is therefore termed "accessory in competence".

[35] In debates on the *Eurohypothec* the question of accessoriness is often treated as doctrine, which then prevents fruitful debate.

[36] It has been found at conferences that discussion between colleagues with a Roman law or German law background becomes very difficult as they generally concentrate on doctrinal observations without being able to analyse adequately and distinguish between the doctrinal principles involved - usually for reasons of time. Discussions with English and Scandinavian lawyers have proved more positive, on the other hand, as they set less store by fundamental doctrinal issues and concentrate more on the practical consequences of topics - therefore dealing with the effects of accessoriness. Great difficulties are encountered, however, when representatives of these two legal and philosophical cultures meet up. The skill here lies in making the other camp aware of the significance of their own material issues so as to arrive at a common base for discussion and arrive at solutions acceptable to all sides.

MORTGAGE CREDIT FOUNDATION

MORTGAGE BULLETIN 21/2005

III. Protection for the owner and the marketability of security rights over real property

When examining the Eurohypothec it is vital, for reasons of legal policy, to take account of the legal position of the owner who is encumbering his property with a security right.

There is, on the one hand, a strong political will to strengthen the marketability of loans secured on real estate in order to facilitate cross-border lending and the funding of mortgage credit through modern capital market instruments.

On the other hand, however, care must be taken to ensure that a reasonable balance of interests is achieved between the need to protect owners and the requirements of legal transactions.[37]

It is particularly significant to consider what happens, if the claim secured has never arisen (e.g. the loan was never paid out to the client) or has already been extinguished (e.g. by repayment). Given that the mortgage is subservient to the loan, what effect does this have?

A distinction must be drawn here between rules of substantive law with regard to the defences to any enforcement of the security right and provisions of a procedural nature.

1. Enforcement and onus of proof in legal proceedings

All European legal systems have rules on the procedure for enforcement of a security right against real estate. These provisions generally form an integral part of their general rules of enforcement. In many countries it is also possible to enforce a claim or even a mortgage immediately, without first having to conduct court proceedings against the debtor/owner.[38]

These provisions are mostly rules of a general nature, which apply equally to debts and mortgages. Enforcement provisions of this kind consequently determine how the onus of proof is to be apportioned. They constitute general rules and are therefore not specific to security rights over real property.

In a discussion of the Eurohypothec, therefore, this topic should be left to national legislatures. No matter whether it is a national hypothec or a Eurohypothec, it will be for the national enforcement laws concerned to determine in what circumstances enforcement proceedings can be instigated and conducted. It might also be conceivable for minimum standards on the subject of enforcement to be laid down in an EU regulation on the Eurohypothec. But uniformity of consumer protection will not, of itself, break down the barriers to facilitate cross-border lending.

[37] The political influence exerted by consumer associations is so great, both in Brussels and in the individual EU Member States, that inadequate discussion of the topic of the protection of owners would inevitably lead to any proposal to introduce a Eurohypothec being rejected out of hand.

[38] In some countries immediate enforcement is possible, if the deed is notarised or if the deed contains an express clause allowing it.

2. The owner's remedies

The procedural remedies available to a debtor subject to enforcement proceedings are also laid down in all European legal systems. These cover the issue of how a debtor can defend himself against enforcement measures taken by a creditor. The latest date by which he has to file pleas or objections so as not to be barred, i.e. prevented from putting his counter-arguments in the proceedings, will be of particular significance. This means, can he successfully put forward a defence under substantive law at a very late stage of the enforcement proceedings - e.g. when the proceeds are being distributed?

This too is a question of general enforcement law within the national legal systems concerned and is not a particular problem of enforcement in relation to security rights over real property.

3. Defences arising from the security agreement

When considering the substantive-law situation, the question that arises is in what instances the owner should be able to raise a defence under the security agreement to counter enforcement of the security right over real property.

A distinction must be drawn here between cases in which

- the owner and debtor are or are not one and the same person, and
- the creditor remains the same, or has assigned its claim under the loan so that a new creditor comes into the picture. Particular problems are found in cases in which

- the security right is assigned to a new creditor in isolation[39] without there being a secured claim in existence (e.g. because it has already been repaid), or
- the secured claim and the security right have been separately assigned to different new creditors.

The legal position should be carefully considered in the context of all variations and combinations of cases so as to achieve a fair balance of interests. The objective should be to ensure that the debtor/owner does not have to pay twice. But what route should be taken here and at what cost should this result be achieved?

Various possible solutions will be set out below, based on different kinds of cases:

(1) It is relatively easy to legislate for a balance of interests where the debtor and owner are one and the same and the creditor does not change.
The debtor/owner can raise the defence under the security agreement against the creditor - e.g. the argument that the security right should not be enforced because the claim does not exist (any longer).

(2) If debtor and owner are not one and the same person it is questionable whether the owner can also raise the defence under the security agreement.

- If the owner is a party to the security agreement, this will be so;

[39] This issue should not be confused with that of the (initially) bare land charge; see in this context Soergel/Stöcker, Notarius International 2002, p. 227 (243).

- If he is not a party to the security agreement the question that arises is whether the defence under the security agreement should nevertheless[40] be available to him[41] - e.g. by providing that these should be quasi *ad rem* consequences.

(3) If the claim alone is assigned to a new creditor, the creditors of the claim and of the security right will be different;

- The debtor can refuse to pay the claim if the security right is not also returned to him when he does so;
- The holder of the security must allow the defence under the security agreement to be cited in opposition to it because he is a party to the security agreement.

(4) If the security right alone is assigned to a new creditor (i.e. without the claim that is to be secured) the question that arises is whether the new holder of the security right should also be bound by the defence under the security agreement.[42]

The particular issue that is raised here is whether it is appropriate to protect the good faith of the assignee as to the non-existence of a defence.

This is a matter of dispute amongst German academic writers. In practice, it would not be very realistic for a bank to be arguing in court that it did not know that the land charge (Grundschuld) was a land charge for security purpose since stand alone land charges are extremely rare in practice. However, although it must generally be assumed to be a secured land charge it is also necessary to assume that there is a security agreement that ties the land charge to the claims to be secured. Consequently, the assignee bank must make enquiries as to the content of the security agreement and examine whether there could be any pleas or objections to enforcement of the land charge arising out of the security agreement.

In the case of the Eurohypothec, therefore, it might have to be provided that a defence under the security agreement could also be cited in opposition to a party acquiring the Eurohypothec. It is questionable how and where this provision should be made. There are several possible starting points in this respect:

- Classifying the Eurohypothec as subservient to other rights. As a consequence it would always be necessary to prove the primary claim before enforcement.

[40] See Clemente, Recht der Sicherungsgrundschuld, p. 210, paragraph 614 (translated): "… Pleas under the security agreement are only available in principle to the party providing the security and not to an owner who is not a party to the security agreement unless an arrangement has been made for the benefit of the owner pursuant to § 328 BGB - Agreements for the benefit of third parties."

[41] See Kircher, p. 58 et seq. and other references, particularly regarding the question of who the party to the security agreement is if the debtor and owner are not one and the same.

[42] For the defence to a land charge that can be cited against an assignee, see Clemente, Recht der Sicherungsgrundschuld, p. 211 et seq. paragraph 621 et seq.; Gaberdiel, Kreditsicherung durch Grundschulden, p. 329 et seq., paragraph 788 et seq.; see also in detail Kircher, Grundpfandrechte in Europa, p. 226 et seq., on defence to a hypothec (p. 227 et seq.) and to a land charge (p. 230 et seq.). See also Baur/Stürner, Sachenrecht, § 45 II 2 c, p. 521 et seq. (translated); "The owner's rights (pleas) under the security agreement or for unjust enrichment are derived from the contract-law links between the land charge holder and the owner. However, they are directed "against the land charge" (… § 1157, sentence 1). Despite their contract-law origins they can therefore also be relied upon as against the assignee of a land charge provided that they are derived from the land register or certificate or are known to the assignee (§ 1157 sentence 2). … This means that such pleas can also be entered in the land register or noted on the certificate." A caution securing a right of restitution can be entered in the land register, for example.

- The *ad rem* effect of the security agreement could be specified, so that it would not be possible for a person acting in good faith to remove a defence from the debtor;
- The entitlement to restitution contained in the security agreement could be secured *ad rem*[43] by way of a caution.[44] However, this would necessitate an entry in the land register. This caution-type effect could therefore also be incorporated by statute. [45]

The last instance (4) shows that the threat of an unjustified or double payment is not the result of non-accessoriness but of the principle of public faith of the land register for official and legal purposes if it makes it possible for a defence under the security agreement to be taken away.[46]

This principle of public faith of the land register for official and legal purposes is not specific to a non-accessory security right, however. In some countries this result is indeed also possible in the case of an accessory hypothec: if a hypothec creditor assigns a hypothec to a third party even though the claim secured does not exist, but this is not known to that third party (i.e. he is acting in good faith), the principle of public faith of the land register for official and legal purposes can then result in the third party acquiring the hypothec - and in the existence of the claim being fictitious to that extent.[47]

[43] It would be conceivable to seek a solution via a statutory caution registering the entitlement to restitution. This entitlement accrues to the party providing the security when the purpose of the security has been fulfilled (e.g. by the repayment of the debt secured). Since the entitlement to restitution is derived from the - contract law - security agreement, it can basically only be implemented by the parties to that security agreement. If the claim is assigned to a new creditor, however, the question that arises is whether the defence to the claim (under the security agreement) can also be enforced against the new creditor. The concept of acquisition in good faith then applies. By entering a caution in the land register the entitlement to restitution would be made *ad rem*. It would therefore no longer be possible to divest in good faith the defence under the security agreement. This solution via a caution would have the advantage that the accessoriness effects protecting the party providing the security would be replaced without destroying the flexibility of the security right.

[44] This means that the party providing the security would be protected from bad faith on the part of the secured party. The caution in respect of the entitlement to restitution means that the substance of the security agreement becomes *ad rem* in character. Enforcement of the security right can therefore be restricted to the claim secured. The secured claim therefore becomes accessorial in implementation. See on this Jaschinska, p. 162 et seq.

[45] A rule corresponding to § 1179 (a) (1) sentence 3 BGB would be conceivable.

[46] Kircher, in Grundpfandrechte in Europa, p. 391, sets this out clearly.

[47] The legal position in the case of the (accessory) hypothec, for example, is
· under German law (§ 1138 BGB); see Baur/Stürner, Sachenrecht, § 38 IV, p. 435 et seq. (translated): "In § 1138 the Act abides by the accessoriness doctrine whilst on the other hand helping to apply the principle of honest acquisition. The good faith effect is therefore also extended to the claim but only insofar as its existence is necessary to carry the hypothec. Although the assignee acquires the hypothec he does not acquire the personal claim. This means in practice that the honest assignee can issue mortgage proceedings against the owner (= debtor) but not a personal contract claim with the aim of enforcement against the whole of his assets." See also in detail Kircher, Grundpfandrechte in Europa, p. 226, particularly p. 227 et seq. on the defence to a hypothec (p. 227 et seq.) and to a land charge (p. 230 et seq.). On the defence to a land charge that can be cited against an assignee see also Clemente, Recht der Sicherungsgrundschuld, p. 211 et seq. paragraph 621 et seq. and Gaberdiel, Kreditsicherung durch Grundschulden, p. 329 et seq., paragraph 788 et seq.
· in Austria as a result of § 469 ABGB. See on this Koziol, p. 359 (translated): "If the claim based on the hypothec has been extinguished then, according to the accessoriness principle, the charge against the property must also come to an end. However, § 469 provides an exception to the dependency principle: the debt-free charge remains in existence, formally speaking, until its deletion has been regularised. However, the owner also has the right, instead of applying for deletion, to use the hypothec released to secure another (new) claim up to the maximum amount of the former. That right of use therefore presupposes extinguishment of the right to the claim … This right of use is available to the property owner for an unlimited period of time. However it is not without risk for him to leave the hypothec standing without a new charge. If the former creditor were to assign the hypothec claim that has really already been extinguished to an assignee in good faith it would be revived because a third party could rely on the completeness of the entries in the land register (negative publication principle). As a result of the principle of good faith in this respect a non-existent claim could be acquired in this exceptional case, the debtor of which would be the land owner. However, his liability would only extend to the property."
· and also under Polish law; see in this context Brockhuis, p. 63.

As only relatively few European legal systems have such a wide principle of public faith of land register for official and legal purposes as the German, Austrian and even the Polish legal systems, consideration might be given to including an express provision to the effect that the defence under the security agreement could be cited in opposition to any party acquiring a Eurohypothec. In that eventuality the Eurohypothec would afford owners the same level of protection as do mortgages available at present.
To enable further work to be carried out on the Eurohypothec, therefore, it is of vital importance to decide a number of issues of legal policy:

- To what extent is it appropriate to prevent an ad rem claim on real estate under a security right from being impossible where a secured claim does not exist or does not exist any longer?
- What level of protection should there be against a double payment?
- What procedural rights and provisions on onus of proof should be created in order to prevent a double payment?
- How far should the principle of public faith in the land register for official and legal purposes be allowed to extend to the Eurohypothec?
- Should these questions be uniformly regulated throughout Europe with regard to the Eurohypothec? Or should it be for the national legislatures concerned to decide whether they should bring in a special rule for the Eurohypothec or apply their general national provisions of land registry law and enforcement law to the Eurohypothec?

The most important question of legal policy, the antithesis of the question of protection for the owner, is the question of the degree of security-right marketability. The higher that degree, the more flexible the financing and refinancing processes that can be structured with the security right. The greater the need for banks to carry out investigations (e.g. if there is no possibility of acquisition in good faith), the higher the bank's administrative costs and therefore ultimately the cost of credit to the client.

A high degree of reliability in the case of a land register or record automatically has the drawback that the proprietors of rights could lose those rights. It is necessary to be aware of this - and all of the legislatures were certainly very well aware of it when they adopted legislation on the public faith of their land registry systems for official and legal purposes.[48]

[48] Thought might therefore be given to restricting the protection of legitimate expectation and therefore the high marketability of a *Eurohypothec* to situations in which creditors of the security right are just those institutions that are subject to official supervision (e.g. banks). However, this should not be sought by way of special provisions governing the public faith of the land register for official and legal purposes as it takes very different forms in Europe. It would really be easier and more appropriate to provide a general rule that a *Eurohypothec* can only be created for a creditor that is subject to official supervision.

IV. Conclusion

■ Work on a common European framework for civil law has been going on for many years. These fundamental discussions have now encompassed property law - and therefore the law governing security rights over real property. The topic of a Eurohypothec, long considered to be a futuristic one, has now become the subject of particular consideration with regard to the future structure of the law on securing credit in Europe.

■ The non-accessoriness of the Eurohypothec is not a dogma or an end in itself. The only vital point is that the Eurohypothec must be flexible whilst at the same time providing an adequate level of protection for owners. Non-accessoriness offers an excellent starting point in this respect. However, it does not have to be slavishly applied at any price.

■ The question of accessoriness and non-accessoriness should not be regarded as simply of black and white. Non-accessoriness should be considered a technical facility for modern security procedures essential in practice enabling debt substitutions to be achieved and allowing for divergence of creditors vis-a-vis the security right and the claim secured.

■ The aim of all future work on a Eurohypothec should therefore be to examine the different types of accessoriness separately and to answer, in respect of each individual type, the technically legal question of the degree of accessoriness that is considered to be necessary in the light of legal policy - or, in other words: what has to be decided is what degree of non-accessoriness of a Eurohypothec can be tolerated, having regard to flexibility and marketability, without neglecting owner protection.

■ Ultimately, for reasons of flexibility and marketability, the preferred middle road could be to define the Eurohypothec as a non-accessory security right, but to provide that it should be of a claim-related type in order to protect the owner when a claim is made.

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C-3. The position of an owner of real estate, which is encumbered with a non-accessory right to property, based on the example of regulations in Poland

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Introduction

Poland is an example of a legal system, which has experienced the influence of many, primarily Prussian, Austrian and French approaches to regulating rights in property.

Under the influence of the Napoleonic Code, which was in effect on Polish territory from 1808, the concept of accessory mortgage was embedded in the legal system. The principle respected here is basically, that a mortgage cannot arise without the prior existence of a debt; the transfer of a mortgage must be accompanied by the transfer of the debt and vice versa. Consequently the repayment of the debt leads to the deletion of the mortgage from the land register.

Despite the fact that mortgage lending in Poland is only at the start of its development (only few percent of real estate use a mortgage as security for loans), one can already clearly see that the strict legal relationship between a debt and a mortgage constitutes a barrier for the development of mortgage loans and use of the potential this presents for the Polish economy.

The last years of economic boom have clearly revealed that accessory mortgages hinder the use of syndicated financing on a greater scale, constitute a barrier to developing a secondary market in real estate and the securitisation of mortgage loans, and favour a monopoly situation in housing loans among the largest banks because a change in lender would have to incur the transfer of the mortgage, which due to time consuming land register procedures is a laborious and problematic process.

This state of affairs inspired the Committee for the Codification of Civil Law, appointed at the Ministry of Justice to draft a law on non-accessory real estate collateral. The draft act is currently subject to adoption by parliament. With this, Poland is joining other new EU countries, such as Slovenia, Hungary, Latvia and Estonia, which are implementing non-accessory real estate collateral, seeing in this the opportunity for the more dynamic growth of mortgage financing.

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The polish law will be introduced under the name of a "dług gruntowy". In its construction it draws on the experience of those countries that accepted the solution of property rights in the form of a certificated land charge (e.g. Switzerland) and the experience and practice of Germany, which provides extensive jurisdiction and banking examples that respectively protect the position of creditor and owner of real estate. It is precisely this aspect - the protection of debtor rights while moving away from the accessory aspect of security - that constituted the key issue in constructing the new collateral right in Poland and constituted the core of discussions by practitioners, theorists and legislators, and now MPs and their experts.

I am presenting below the most important disputed points and solutions that have been accepted, which secure the interests of an owner of real estate in the Polish draft law on land charges.

I. Issues related to the introduction of non-accessory mortgages to an accessory legal system

Is it better to modify existing accessory mortgages to achieve the assumed "loosening up" effect of its accessory nature, or perhaps introduce a new type of security on real estate, operating in parallel?

In Poland, after a quite intensive discussion, the second of these solutions was favoured. Pragmatic arguments prevailed. Economic relations are currently based on accessory law. One should rationally assume that changes in this law, particularly if they cover important or dogmatic principles, will give rise to interpretative doubts during their period of implementation that will be difficult to anticipate. It is safer to allow an option in the legal system, which does not interfere with existing mortgages. It would be used as economic needs dictate and the legal maturity of the new solutions advances (the supplementation of executive acts of a lower order, court procedural instructions, practical examples), and a more solid legal awareness among market players takes hold.

In conclusion, the most important argument in favour of introducing a non-accessory right as a new instrument was: continuity in the safety of transactions and not disturbing the functioning of mortgages, which satisfy their role in simple and traditional lending relations.

What should be the relation between existing accessory mortgages and the new non-accessory real estate collateral (the rights of other creditors disclosed in the land register)?

The regulations defining the principles for transforming a mortgage into a non-accessory right and vice versa are important in this issue. The Polish draft law does not anticipate the possibility of transforming already established mortgages into a land charge. For new mortgages, created after the act has come into effect, this will be possible.

However, the principle is respected here that the rights of creditors entered in the land register in lower orders of priority cannot later be limited. In that case, their consent would be necessary. During the discussion it was pointed out that creditors entered later in the order for transformation loose, if their right to the value of the real estate does not move forward. The value of the land charge "blocks" the amount declared in the entry, even if the debt pursued actually proves to be smaller. These issues should therefore be regulated in detail in the context of the possibility of transforming one right into another.

Should one regulate in detail the right to establish, transfer and expiry of a non-accessory mortgage, or only introduce the definition of a new means of security, leaving the remainder for practice and judgements?

German, Estonian and Hungarian Slovenian law on non-accessory mortgages regulate these rights of security very basically. The assumption is made that due to the lack of connection with a credit, a large part of the legal relations between a creditor and a debtor remains in the sphere of a contractual right, not a right in property. At the same time it specifies there that for land charges the procedural regulations on mortgages are similarly applied, with the exception clearly of those that would implicate its accessory nature. In this model of regulatory convention one should pay particular note to judgement and the long period of practise necessary to transform the position of debtor into a creditor in a manner protecting his interests with respect to the stronger position of creditor, e.g. a bank.

The Polish legislator has responded in favour of the need for specific regulation of a land charge. In the civil code therefore, after the section on "Mortgages" a new section on "Land charges" is introduced, which apart from its definition directly regulates the following areas of its functioning:

- the subject,
- emphasising where the lack of accessory nature manifests itself (in its establishment, transfer, no confusion with the credit, expiry, waiver, and deletion from the land register),
- the form, content, and function of a security agreement,
- construction of a combined land charge based on the example of a combined mortgage,
- the transformation of a mortgage into a land charge and vice versa,
- a certificated land charge (the content of the certificate and template, the means of disclosing it in the land register, the procedure for issuing a certificate, transferability and redemption or enforcement, conversion of a certificated land charge into a registered land charge and vice versa, the situation where the certificate is destroyed, lost or damaged),
- a land charge in enforcement and bankruptcy proceedings (which constitutes a title of enforcement, suits for discontinuance of enforcement in civil proceedings due to a debtor / owner of real estate, and the order in which debts are secured),
- reference to land registers in other provisions, for example, in regulations on court costs and tax regulations.

As a result new regulations on land charges will be included in about 70 articles, not counting those prepared along with draft provisions of a lower order.

SUMMARY

In support of this concept of detailed regulation was the wish to extend care over the position of the owner of real estate and land charge debtor. The new non accessory collateral includes precise regulations of his rights at every stage of the "life" of the non-accessory security on real estate. The scope of regulation was set up, after prior careful analysis of judgements and critical points of non-accessory rights of countries with many years practise in this respect.

The above concept also required a high level of legal skill in balancing the wish to specify step by step the legal procedures and not transgressing into accessoriness, in order to retain all the assumed benefits from the functioning of this right of security separated from credits. Despite the accusations encountered that there is repetition of certain regulations, which can also be found with mortgages, the **benefit here for a mortgagor** is certainly the clear expression of regulation in one place of the act, without the need to make any presumed interpretations.

Work on such a challenging draft and achieving a general consensus therefore took over five years, and it is estimated, that its implementation will take several more years.

Nonetheless, the result is a draft which constitutes proof of the possibility of introducing non-accessory security rights in a environment of a strict accessory mortgage in operation, while respecting the rights of the owner of real estate and debtor at a level no less than with an accessory mortgage.

II. Examples of solutions, which despite separating security from credits, ensure the safety of the rights of a real estate owner

1. The role of a notary

During discussions on the participation of a notary, the issue was raised on the one hand of an increase in legal security for the parties taking part in lending relations secured on real estate, and on the other hand the effects were analysed of higher costs of establishing security and the reduced elasticity in a practise. That is because the notarised form required for the specific legal activity is also necessary for each change in its provisions.

The solutions accepted, compared with a mortgage, impose a higher regime in terms of the legal form **for establishing a land charge** (the form of a notary deed to establish a charge, no possibility of making an entry in the land register purely on the basis

of bank accounting books, which is possible in Poland with a mortgage). Also the so called contracts for security, in which the rights of a debtor, the purpose of the security etc. are defined, also require the participation of a notary. A notary in accordance with the draft act plays a very important role in drawing up a certificated land charge as well as transferring the rights incorporated in it.

This kind of solution, despite the fact that it slightly limits the freedom to apply flexible security, does not negate its functionality and gives the owner of real estate or debtor the chance to become aware of the legal consequences of taking a decision to encumber real estate with a non-accessory mortgage.

As with international standards, Polish law clearly imposes on a notary an obligation to inform the parties. The polish law on notaries states, among others: "a notary in performing notary activities is obliged to ensure the proper protection of the rights and due interests of the parties and other persons, for whom this activity may cause legal consequences .... the notary is obliged to grant the parties necessary explanations...".

2. The role of a security contract and the rights of the debtor

With the non-accessory right of security, which does not automatically share the fate of credits, there were discussions during work on the draft of the various possible threats that a debtor may potentially encounter. In what way should the will of the parties be established with respect to the purpose of the security, extent or conditions for deleting a non-accessory mortgage from a land register, if the loan agreement itself cannot be a point of reference?

a) The formal documentation of the intent of the parties

The solution accepted in the draft law introduces a kind of connection between a loan or credit agreement (which can, but does not have to be, the purpose of the security) and the declaration to establish a land charge on real estate. The Polish legislator has gone further than the solutions of other countries on the question of form, and the contents of this contract have not simply be left to the intentions of the parties.

In analysing what could constitute a threat for the owner of real estate, the Polish legislator formulated obligatory points with respect to the provisions of a contract, i.e. the purpose of establishing and the scope of exercising the land charge and an indication of the legal relationship, from which the credit secured results. Currently there is a discussion in parliament regarding an option to extend these minimum provisions to include a provision on what is to happen to the "surplus" of the amount of the debt that encumbers the real estate over the credit pursued in enforcement proceedings. The typical situation will probably be that, the value of a debt, accepted as security exceeds the value of the loan, so the question of the "surplus" should be clear.

b) There is the question of whether the contract for security should be disclosed in the land register

The discussion revolved around the issue of the certainty of the transferability of real estate encumbered with security with respect to the certainty of the real estate debtor that his rights resulting from the contract for security will be respected by every purchaser. Forcing respect of these rights would guarantee the principle of public confidence in land registers. This would be the case if an obligation was imposed to enter the security contract in land registers. However, on the other hand the question would arise as to whether such a solution does not actually mean an accessory nature and deprive the idea of its entire sense.

This same problem also leads to the question asked in this way: what happens when dishonest vendor concealed a security contract (or the latest version) and sold the land debt. The purchaser is in good faith. The owner of real estate repaying a loan might some time in the future be greatly surprised to receive a demand for satisfaction from the land charge as a separate enforcement title (because as non accessory right it is separate to the loan).

The solution accepted in Poland, preventing the possibility of situations enabling criminal activity, is as follows:

- firstly the land register records the fact alone (and not the content) of concluding a contract for security, thanks to which every purchaser of land debt knows or can easily find out that such a contract has been concluded and they can deduce the limitations in performing the non-accessory mortgage resulting from it,
- secondly the act imposes on the party transferring a charge (security) the obligation of informing the purchaser of the provisions of the security contract, and in the event of failing to meet this obligation then he must redress any resultant damage (including with respect to the debtor or owner of the real estate),
- the act additionally strengthens the rights of a debtor by stating *expressis verbis* that a security contract is effective with respect to every party acquiring the land charge,
- at the same time, the content of a contract can be flexibly changed, without registrations in the land register.

It seems that this solution sensibly satisfies eliminating the risk of the double payment from a charge and from a debt, in the event of the separation of these rights over two differing entities, without removing the security aspects of non-accessoriness.

3. The position of debtor and holder of real estate in enforcement proceedings relating to the real estate

The Polish draft law has clearly accepted that the owner of real estate and debtor are entitled to the same suits for discontinuance of enforcement in civil proceedings as

a debtor with an accessory mortgage. By referring to the security contract and its improper execution by a creditor, the owner of real estate can stop enforcement until the resolution of the dispute. Nonetheless it is worth emphasising that in a typical situation, when, for example, a bank properly exercises its rights to pursue a land debt (no protest from the owner of the real estate), then the enforcement officer does not check the situation and does not demand the presentation of a loan agreement. Therefore, it is that much simpler and faster to enforce the creditor's claims.

4. A non-accessory land charge as a limited term right

The most far reaching solution criticised by practitioners, which the Polish draft law has accepted for the benefit of the owner of real estate and debtor, is the time limitation in the existence of an established land charge of 30 years. Such a "safety fuse" was accepted in the event of the unclear definition by the parties of the conditions for deleting a debt from the land register or the overlooking of this fact in the security contract. However, the solution accepted does not lead to automatic expiry, as assumed in the original version. It is the right of the owner of real estate (after existing the land debt for 30 years) to repay the outstanding amount and redeem the debt, and demand its deletion in the land register.

C-4. Options under EU Law for the Implementation of a Eurohypothec

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Introduction

This paper starts from the assumption that a Eurohypothec should constitute a "26th legal model" available all over Europe. In other words, it should be an additional option for citizens and banks, available alongside national security rights, which should remain in place. This paper will analyse the various options available not only to enable implementation of a uniform model of Eurohypothec, but also to encourage political and legal processes which might ultimately lead to the creation of such an instrument. Strategically, these options involve not only the European legislator, but also other actors such as the ECJ and regulatory competition between different national laws.

I. Mutual recognition of existing national security rights

1. The duty of mutual recognition

In the famous 1979 *Cassis de Dijon* case, the ECJ stated that the limitation of the basic freedoms (i.e. free circulation of goods, services, persons and capital, Grundfreiheiten in German) on account of mandatory national interests (e.g. consumer protection) was not proportional if equivalent guarantees existed in the State of origin. Thus, a Member State may no longer reject the importation of a foreign good on the grounds that it does not comply with national product regulation (prescribing, for e.g., certain components or ingredients), if the objective of such regulation (e.g. product safety or consumer protection) is already adequately fulfilled by similar regulation in the State of origin.

In recent years, this jurisprudence has famously been transferred to corporate law. Thus, in its decisions *Centros*, [49] *Überseering*[50] and *Inspire Art*,[51] the ECJ forced Member States to accept foreign forms of companies, such as English private limited companies (without any minimum social capital). Despite the "seat theory" of private international law, adhered to in many European countries and according to which companies are governed by the law of the real seat of their administration, Member States must now register companies established in other European states according to the

[49] Rs. C-212/97, *Centros*, Slg. 1999, I-1459.
[50] Rs. C-208/00, *Überseering*, Slg. 2002, I-9919.
[51] Rs. C-167/01, *Inspire Art* v. 30.9.2003, nyr.

law of that state. In other words, the ECJ has forced Member States to accept the private international law "incorporation theory" (under which a company is governed by the law of its place of origin) rather than the "seat theory".

This reasoning could in theory be transferred to real property law, with the effect that Member States would - against the principles of lex rei sitae and numerus clausus of real rights - have to accept any real security right created under the law of another Member State. However, at the present stage, it is likely that the lex rei sitae principle is still justifiable to a far greater extent than the "seat theory" in company law. This result may be derived from consideration of ECJ jurisprudence in the *Trummer*[52] case.

2. The *Trummer* case

The *Trummer* case is a fundamental decision on the relationship of the basic freedoms and real sureties. In this case, an Austrian prohibition on registering mortgages in foreign currencies was at stake. In its decision, the ECJ first confirmed the extension of the scope of free circulation of capital to mortgages, as these "represent the classic method of securing a loan linked to a sale of real property".[53] Then, the Court found a violation of the freedom right:

"The effect of national rules such as those at issue in the main proceedings is to weaken the link between the debt to be secured, payable in the currency of another Member State, and the mortgage, whose value may, as a result of subsequent currency exchange fluctuations, come to be lower than that of the debt to be secured. This can only reduce the effectiveness of such a security, and thus its attractiveness. Consequently, those rules are liable to dissuade the parties concerned from denominating a debt in the currency of another Member State, and may thus deprive them of a right which constitutes a component element of the free movement of capital and payments." [54]

Following the ordinary scheme of analysis of the basic freedoms, the Court then went on to examine possible justifications of the violation. In this context, it made a statement of principle as regards real sureties:

"It should be noted that a Member State is entitled to take the necessary measures to ensure that the mortgage system clearly and transparently prescribes the respective rights of mortgagees inter se, as well as the rights of mortgagees as a whole vis-a-vis other creditors. Since the mortgage system is governed by the law of the State in which the mortgaged property is located, it is the law of that State which determines the means by which the attainment of that objective is to be ensured." [55]

[52] Case C-222/97, *Trummer and Mayer*, ECR 1999, I-1661; confirmed in case C-464/98, *Stefan*.
[53] ECJ, at no. 23.
[54] ECJ, at no. 26.
[55] ECJ, at no. 30.

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In the remainder of the case, the ECJ did not, however, accept the Austrian prohibition as a proportional limitation on the free movement of capital. Assuming that the Austrian rule was designed to attain the objective of a clear and transparent mortgage system, the Court accused it of enabling lower-ranking creditors to establish the precise amount of prior-ranking debts and thus to assess the value of the security offered to them, only at the price of a lack of security for creditors whose debts were denominated in foreign currencies.

In my view, this argument is not convincing, as the alternative solution of admitting mortgages denominated in a foreign currency would, in turn, cause a lack of security for lower-ranking creditors. Hence, a solution affecting nobody adversely is not available and, under these circumstances, it should have been within the discretion of the Member State to opt for its preferred solution. However, and this seems to have been the decisive rationale for the decision, Austrian law may be criticised for not operating the choice consistently. Indeed, the Austrian rules allow the value of the mortgage to be expressed by reference to the price of fine gold, which is subject to fluctuations in the same way as the value of a foreign currency. As a result, the decision is acceptable for this reason.

3. Intermediate result

In light of the *Trummer* case, the principles of lex rei sitae and the numerus clausus of real rights are likely to be accepted as "necessary measures to ensure that the mortgage system clearly and transparently prescribes the respective rights of mortgagees *inter se*, as well as the rights of mortgagees as a whole vis-a-vis other creditors." Therefore, a duty of mutual recognition of national security rights is unlikely to be recognised by the ECJ at the present stage.

4. The duty of transposition

If a duty of mutual recognition is not accepted, nevertheless a duty to transpose a foreign security right into the national right to which it is closest (if such a right exists!) persists as long as the latter does not give the creditor a better position ("transposition into a minus"). Such a transposition is mandated by the basic freedoms. Indeed, a restriction of the freedom of capital (which encompasses the right of a debtor to secure debt by mortgage) through the wholesale non-recognition of a foreign real property right is not proportional if the right could have been exercised, after the good has crossed the border, in the form of a similar national security right.

To give a concrete example, the German BGH has decided that an Italian (registered) mortgage on a car which does not exist in Germany may nevertheless be exercised in Germany according to the rules on Sicherungseigentum ("fiduciary property").[56] Significantly, the Sicherungseigentum is worth less than the registered mortgage, in

[56] BGH NJW 1991, 1415.

particular since bona fides acquisition by third parties is not excluded. However, this transposition of the Italian mortgage on movables is still much better than giving the creditor nothing at all.

On this reasoning, one might claim in theory that a non-accessory German Grundschuld must be transposed into say an accessory French or Italian mortgage when transferred to real estate located there - which would give the creditor a slightly worse position ("transposition into a minus"). However, this solution will not prove particularly helpful for the parties as the transposition (including registration) is likely to be at least as cumbersome as the registration of a new French or Italian mortgage.

II. Creation of a European instrument

1. Art. 94, 95 EC

The special legal basis for the implementation of the free circulation of capital - old Art. 69 EC - was abolished by the Treaty of Amsterdam, as this freedom has been deemed already achieved. To regulate issues related to freedom of capital, including the granting of security rights, the general legal basis for the approximation of market legislation, i.e. Arts. 94 or 95 EC, must therefore be used. As regards Art. 94 EC, this provision requires unanimity in the Council of Ministers and enables only directives. Under Art. 95 EC, however, market legislation may be enacted by a qualified majority in the Council and a majority in the EP (in the co-decision procedure according to Art. 251 EC), and both directives and regulations are possible. It is true, however, that in a declaration on the Single European Act (OJ 1987 L 169/24), the Member States laid down their preference for directives. This can however only apply in the case of equal suitability, which would be difficult to sustain here (see below sub 2).[57]

However, under Arts. 94 and 95 EC only a measure replacing national instruments would seem covered, but not a European instrument existing alongside them. According to ECJ case law on the Treaty setting up the World Trade Organisation (WTO), Art. 95 EC allows only the European shaping of national legal institutions, but not the creation of "new titles overlaying national ones" (europäisches Sonderrecht).[58]

2. Art. 308 EC

On the basis of this jurisprudence, for a "26th model" instrument, only Art. 308 EC would seem to remain as an appropriate legal basis. Here again, a directive or a regulation would be possible:

a) Directive

As it is always the case with this type of legal instrument, a directive to be transposed into national law would leave more leeway of implementation to the Member States.

[57] Basedow, AcP 200 (2000), 480.

[58] Opinion 1/94, WTO, ECR 1994, I-5267, N° 59. See Tilmann/van Gerven, in: Study of EU private-law systems in relation to discrimination and the creation of a European civil code, European Parliament, Directorate-General for science, legal questions series, JURI 103 DE and EN (October 1999), Director: Christian v. Bar, 183, 195 N° 50ff.

Thus, a directive could contain the mandate to implement a model of a Eurohypothec (possibly similar to the one described in the "basic guidelines"). Against the wording of Art. 249 EC, it is recognised in European practise that a directive, whilst not being directly applicable as a rule, may not only lay down general objectives but also contain detailled provisions in a code-like manner. Notwithstanding that, due to different national implementation legislation, we might face 25 slightly different national versions, whose compatibility with the directive would, as is typically the case with directives, remain controversial in the details. As a consequence, as what may happen with the Societas Europea, distinguishing between the various national versions of the Eurohypothec would likely be a difficult and time consuming enterprise, possibly neutralising the advantages of a European instrument altogether.

b) Regulation

Against this background, a regulation based on Art. 308 TEC is likely to be the only remaining possibility. Indeed such an instrument may be regarded as preferable. On account of its considerable technical specificities, the Eurohypothec is likely to require uniform legislation directly applicable in all Member States with the same wording to be effective.

Ultimately, irrespective of whether a directive or a regulation is chosen, it is certainly politically improbable that all Member States will agree on a uniform and detailed blueprint for the Eurohypothec.

3. Art. 308 EC combined with Arts. 11 EC and 43-45 EU

However, the consensus problem could be overcome by resorting to the mechanism of enhanced co-operation among the interested Member States only (occasionally also called flexibility or "various speed Europe") - or an international agreement outside Community law. Despite what various voices in the literature say,[59] the latter would appear not to be excluded by the provisions on enhanced co-operation. Still, such an agreement would have the usual international-law drawbacks, such as the danger of "rigidification" (with amendments requiring unanimity) and possibly also of democratic deficits. A measure of enhanced co-operation would by contrast have the advantages of being able to utilize the Community's institutional infrastructure, presumably easing subsequent necessary amendments. Significantly, the provisions on enhanced cooperation have been upgraded considerably in the Nice Treaty, so as to counteract probable rigidities in a Union of 25 and more members.

Technically, the conditions for enhanced co-operation laid down in Arts. 11 EC and 43-45 EU would need to be observed. Thus, a minimum of eight Member States would have to join the project from the start (Art. 43(1)(g) EU). Also, enhanced co-

[59] On the state of opinions see B. De Witte, 'Old-fashioned Flexibility: International Agreements between the Member States of the EU', in: G. De Búrca and J. Scott (eds.), *Constitutional Change in the EU - From Uniformity to Flexibility* (Hart, 2000), 31 (55).

operation has ultima ratio character and is only available when other attempts have failed within a reasonable period of time (Art. 43a EU). However, the former veto right for each Member State contained in Art. 11(2) EC has been abolished by the Nice Treaty. In addition, it should not be ignored that if enhanced co-operation were rejected by non-participating Member States the unstoppable alternative in the air would be an international agreement outside the Community - where non-participating Member States would in principle have no rights at all. Therefore, a Eurohypothec concluded as a measure of enhanced cooperation would have good chances of succeeding.

However, a Eurohypothec limited to a group of Member States may entail "freerider" problems: banks of State A which has not introduced the instrument may use it with economic benefit in State B, whilst banks of State B will not be able to use it in State A. In this context, it is legally and politically problematic to forbid the use of the instrument for banks established in a non-participating Member State. On the other hand, just as what happened with the Social Protocol (to which the UK opted out in Maastricht but accepted it in Amsterdam), good experiences in some Member States might convince others to introduce it as well - also, internal economic operators, mortgage banks in particular, might put pressure on their home State to do so. Ultimately, all these consequences are very difficult to predict and assess.

FINAL RESULT

It seems most realistic to envisage a Eurohypothec as a regulation based on Art. 308 EC and combined with the device of enhanced co-operation (Arts. 11 EC and 43-45 EU). This would enable willing Member States to take the lead and put pressure on unwilling States to join later. This might be particularly so if the Eurohypothec were to prove economically advantageous after its introduction and were to put the unwilling Member States under competition pressure emanating from national economic actors. On the other hand, there may be adverse freerider problems when banks of a determined Member State can use the Europhypothec abroad but would not face foreign competition at home if their home State has not introduced the instrument as well.

ANNEX: PROVISIONS ON ENHANCED COOPERATION

Article 11 EC

1. Member States which intend to establish enhanced cooperation between themselves in one of the areas referred to in this Treaty shall address a request to the Commission, which may submit a proposal to the Council to that effect. In the event of the Commission not submitting a proposal, it shall inform the Member States concerned of the reasons for not doing so.

2. Authorisation to establish enhanced cooperation as referred to in paragraph 1 shall be granted, in compliance with Articles 43 to 45 of the Treaty on European Union, by the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament.

When enhanced cooperation relates to an area covered by the procedure referred to in Article 251 of this Treaty, the assent of the European Parliament shall be required.
A member of the Council may request that the matter be referred to the European Council. After that matter has been raised before the European Council, the Council may act in accordance with the first subparagraph of this paragraph.

3. The acts and decisions necessary for the implementation of enhanced cooperation activities shall be subject to all the relevant provisions of this Treaty, save as otherwise provided in this Article and in Articles 43 to 45 of the Treaty on European Union.

Article 11a EC

Any Member State which wishes to participate in enhanced cooperation established in accordance with Article 11 shall notify its intention to the Council and to the Commission, which shall give an opinion to the Council within three months of the date of receipt of that notification. Within four months of the date of receipt of that notification, the Commission shall take a decision on it, and on such specific arrangements as it may deem necessary.

Article 43 EU (*)

Member States which intend to establish enhanced cooperation between themselves may make use of the institutions, procedures and mechanisms laid down by this Treaty and by the Treaty establishing the European Community provided that the proposed cooperation:

(a) is aimed at furthering the objectives of the Union and of the Community, at protecting and serving their interests and at reinforcing their process of integration;

(b) respects the said Treaties and the single institutional framework of the Union;

(c) respects the acquis communautaire and the measures adopted under the other provisions of the said Treaties;

(d) remains within the limits of the powers of the Union or of the Community and does not concern the areas which fall within the exclusive competence of the Community;

(e) does not undermine the internal market as defined in Article 14(2) of the Treaty establishing the European Community, or the economic and social cohesion established in accordance with Title XVII of that Treaty;

(f) does not constitute a barrier to or discrimination in trade between the Member States and does not distort competition between them;

(g) involves a minimum of eight Member States;

(h) respects the competences, rights and obligations of those Member States which do not participate therein;

(i) does not affect the provisions of the Protocol integrating the Schengen acquis into the framework of the European Union;

(j) is open to all the Member States, in accordance with Article 43b.

(*) Article amended by the Treaty of Nice.
EN C 325/28 Official Journal of the European Communities 24.12.2002

Article 43a EU (*)

Enhanced cooperation may be undertaken only as a last resort, when it has been established within the Council that the objectives of such cooperation cannot be attained within a reasonable period by applying the relevant provisions of the Treaties.

Article 43b EU (*)

When enhanced cooperation is being established, it shall be open to all Member States. It shall also be open to them at any time, in accordance with Articles 27e and 40b of this Treaty and with Article 11a of the Treaty establishing the European Community, subject to compliance with the basic decision and with the decisions taken within that framework. The Commission and the Member States participating in enhanced cooperation shall ensure that as many Member States as possible are encouraged to take part.

Article 44 EU (**)

1. For the purposes of the adoption of the acts and decisions necessary for the implementation of enhanced cooperation referred to in Article 43, the relevant institutional provisions of this Treaty and of the Treaty establishing the European Community shall apply. However, while all members of the Council shall be able to take part in the deliberations, only those representing Member States participating in enhanced cooperation shall take part in the adoption of decisions. The qualified majority shall be defined as the same proportion of the weighted votes and the same proportion of the number of the Council members concerned as laid down in Article 205(2) of the Treaty establishing the European Community, and in the second and third subparagraphs of Article 23(2) of this Treaty as regards enhanced cooperation established on the basis of Article 27c. Unanimity shall be constituted by only those Council members concerned.

Such acts and decisions shall not form part of the Union acquis.

2. Member States shall apply, as far as they are concerned, the acts and decisions adopted for the implementation of the enhanced cooperation in which they participate. Such acts and decisions shall be binding only on those Member States which participate in such cooperation and, as appropriate, shall be directly applicable only in those States. Member States which do not participate in such cooperation shall not impede the implementation thereof by the participating Member States.

Article 44a EU (***)

Expenditure resulting from implementation of enhanced cooperation, other than administrative costs entailed for the institutions, shall be borne by the participating Member States, unless all members of the Council, acting unanimously after consulting the European Parliament, decide otherwise.

(*) Article inserted by the Treaty of Nice.

(**) Article amended by the Treaty of Nice.

(***) Article inserted by the Treaty of Nice (former Article 44(2)).

EN 24.12.2002 Official Journal of the European Communities C 325/29

Article 45 EU (*)

The Council and the Commission shall ensure the consistency of activities undertaken on the basis of this title and the consistency of such activities with the policies of the Union and the Community, and shall cooperate to that end.

D. Excerpts from the Recommendations of the Forum Group on Mortgage Credit

REPORT BY THE FORUM GROUP ON MORTGAGE CREDIT
EUROPEAN COMMISSION
INTERNAL MARKET DIRECTORATE GENERAL*

This Report is published by the European Commission. The views expressed within it are views of the Group and its members, and not the European Commission.

[...]

CHAPTER 2
LEGAL ISSUES

I. CONFLICT OF LAWS

(55) 'Conflict of law' in this context, is intended to refer to the conflict between different consumer protection and other rules prevailing in different jurisdictions.

(56) The mortgage transaction consists of two separate contracts, the mortgage loan contract and the constitution of the collateral (mortgage deed).

(57) As regards the mortgage loan contract, the Rome Convention[22] provides the general principle of free choice of applicable law, although Article 5 of the Convention enshrines specific rules for consumer contracts. With regard to the constitution of the mortgage collateral, the principle of 'lex rei sitae', that is, the law of the country where the property is situated, applies. Finally, in countries where a strong linkage exists between the mortgage deed (collateral) and the loan contract, such as France and Austria, lex rei sitae might be extended to the loan contract.

(58) Thus the following jurisdictions may apply to a mortgage loan contract, demonstrating the potential for legal uncertainty for cross-border mortgage contracts: (i) the jurisdiction of the home country of the lender, (ii) the jurisdiction where the property is situated, or (iii) the jurisdiction where the consumer is domiciled.

[22] Convention on the Law applicable to Contractual Obligations (80/934/EEC)

* European Communities, 2004
http://europa.eu.int/comm/internal_market/finservices-retail/docs/home-loans/2004-report-integration_en.pdf

(59) Conflict of law rules need to address both the mortgage loan contract and the mortgage deed, in order to produce appropriate and transparent solutions for cross-border borrowers and mortgage lenders. They should also address security agreements concluded in those countries where non-accessory mortgage collaterals exist and need to be linked to the loan contract by a specific agreement[23].

Main barriers identified

Confusion about applicable law

(60) Some Industry Representatives are of the view that legal uncertainty about the applicable law is a major barrier to cross-border mortgage lending. Others consider that of equal importance are factors such as consumer confidence and a preference for proximity and close customer-lender relationships.

Member State Attitudes

(61) Industry Representatives consider that Member States' attitudes to infringements of their consumer protection legislation (including the potential ultimate sanction for such infringement of rendering the mortgage loan contract void), discourages lenders from lending across borders to consumers. Consumer Representatives consider rather that consumer confidence results from such consumer protection, which cannot therefore be regarded as a barrier to cross-border activity. They doubt the extent to which such consumer confidence would be improved only by the applicability of foreign legislation to consumer contracts.

Discussion

(62) The Forum Group considered that there was no evidence to support a view that the mortgage deed and the loan contract must always be governed by the same jurisdiction. There appeared to be no obstacle to the coverage of the mortgage deed by the law of one country and the coverage of the loan contract by the law of another country. This view applied also to countries with a strong accessory linkage between the loan contract and the mortgage deed, as, for example, where both contracts are part of one single authentic instrument.[24]

(63) That said, Industry Representatives consider that it was very important to introduce one single conflict of law rule, in order to determine the applicable law. They are convinced that the mandatory and systematic application of the law of the consumer's residence to cross-border loan contracts, would suffocate further market integration. They indicated that credit institutions were not able to provide 25 different but competitive and cost-efficient home loan products within the EU.

[23] A Security Agreement is defined for our purposes as a contract outlining the intended use by the contracting parties of the mortgage collateral. For further discussion on the 'accessory' concept, please see chapter 2 on Collateral Issues.
[24] This is, for example, lender practice in France. The term authentic instrument refers to a notary act providing for a link between the loan contract and the mortgage deed.

(64) Thus many Industry Representatives were of the view that in order to benefit from competitive cross-border loans and product variety, consumers should be allowed to submit the mortgage loan contract to the jurisdiction of the mortgage lender's home country. Such 'mutual recognition' was, they considered, vital to boost market integration and facilitate lender competitiveness. They argue that consumer protection could be ensured by requiring the mortgage lender to fully inform the borrower about the mortgage product. Alternatively, sufficient consumer protection standards could be introduced as a basis for such mutual recognition.

(65) Other Industry Representatives, concerned about the applicability of mutual recognition, pointed out that its effect would be restrained by the applicability of Member States' legislation falling with the 'general good' arena, as allowed by EU banking legislation.[25] They argue that targeted harmonisation would be a more effective way to achieve the goals of a single market. They were of the view that in retail banking, tailor-made services and consumer confidence are of the utmost importance. Therefore, there is a natural process of adaptation of retail products or services to local demand. The application of the principle of mutual recognition in the area of mortgage lending would, in their view, lead to a distortion of competition and clearly run counter to current market trends and therefore greatly upset practices at both industry and political level, having a potentially detrimental impact on consumer confidence.

(66) Consumer Representatives share this concern about mutual recognition. They argue that mutual recognition and the mere application of foreign legislation to their contracts would start a race to the bottom as far as consumer protection was concerned and therefore do little to address consumer confidence and quality of choice.

(67) Consumer Representatives were also sceptical about the apparent benefits of the 'free choice of contract law' for consumers given the complexity and lack of knowledge about home jurisdictions, never mind others. The free choice of law was considered to be very much an illusion, in that consumers would have to accept the choice of law offered by the lender. Consumer confidence would suffer further in this respect, if the level of consumer protection enjoyed under such a choice was lower than that afforded by domestic legislation. In any event, expecting consumers to be able to make an informed choice between 25 sets of national laws did not appear realistic to them. They argued that the complexity of products and information asymmetry limit drastically any potential benefits consumers could gain from any extension of choice. They advocate minimum harmonisation through binding rules to ensure a high level of consumer protection. Consumer Representatives considered that for the most important financial decision in their lives, consumers expect to benefit from at least as high a level of consumer protection as that prevailing under their national law.

[25] Article 22§5 of Directive 2000/12/EC of the European Parliament and of the Council. OJ L 126/1 of 26.05.2000 .

Recommendations

19 **The Commission should ensure that the applicable (substantive) law for the mortgage deed and any related security agreement is the law of the Member State where the property is located (lex rei sitae).**

20 **Industry Representatives advocate that the Commission should ensure that the applicable law for the mortgage loan contract is defined by a general conflict of law rule based upon the principle of free choice. The Rome Convention should be amended accordingly, provided that certain essential standards are met. Member States should no longer be able to seek to impose any additional national consumer protection rules to cross-border mortgage loan contracts. For further details see Industry Recommendations 13 - 18 on Consumer Confidence.**

21 **Consumer Representatives do not agree with Recommendation 20 that the applicable law for the mortgage loan contract should be defined by a general conflict of law rule based on the principle of free choice and accordingly reject the proposal for such an amendment of the Rome Convention. Instead they recommend the retention of the specific rules on consumer protections contained within the Rome Convention and advocate the additional protections described in Recommendations 8-12 on Consumer Confidence.**

II. CLIENT CREDIT-WORTHINESS

[...]

III. PROPERTY VALUATION

[...]

IV. CROSS-BORDER FORCED SALES PROCEDURES

[...]

CHAPTER 3
COLLATERAL ISSUES

I. REGISTRATION

(103) Most real estate charges are submitted for registration in Member States. Registration systems vary significantly and range from informal (and unsecured) registration to high security systems. Furthermore, the apparent security given to lenders by registration may, to an extent, be illusory. This is because a broad range of private or public overriding interests can interfere with the legal value of the registered rights. Main barriers identified

Transparency of information

(104) National Registers are not always as readily accessible and comprehensive as they could be, albeit that there are initiatives underway to address this, such as EULIS.[31]

Hidden Overriding Interests

(105) Member States have differing registration requirements for overriding interests. Such differences can reduce the level of legal certainty and interfere with real estate charges, which are subject to the same registration system. These overriding interests may be created by a private individual or by a public authority, and cause a change in the value of the real estate charge securing a loan. This is, of course, an obstacle for the national market, but it represents also a significant barrier for external access to the market and cross-border lending.

Duration of mortgage enrolment

(106) Under some legislation, for example in France, the duration of a mortgage is limited. For both the customer and the bank, the mortgage is a legal instrument to secure a loan. It should, therefore, have a lifespan of at least until the point at which the loan matures.

Difficulties with accessing registration systems

(107) At present, in order to access national registration systems, foreign market participants use the freedom of establishment mechanism to operate abroad, which leads to higher market access costs.

[31] In the EULIS initiative, official land registration organisations from 8 European countries are cooperating to develop a pan-European land information service. See Annex V for further details.

Discussion

(108) The Forum Group did not consider that different registration procedures or security standards were themselves a barrier. Rather, the problem appeared to lie in the insufficient centralisation of the information, necessary to enable a foreign market partner to have equal access to the mortgage credit market.

Recommendations

30 The Commission should ensure that:

- **all charges affecting real estate must be registered in a Public Register in order to be binding on and take effect against third parties, regardless of their nature;**
- **the creation, modification or extinction of a charge on real property[32] shall become effective vis-a-vis third parties only at the point of registration in the Public Register; and**
- **registered charges on real property in relation to the same estate shall rank in the order of priority disclosed in the Public Register.**

31 For filings of applications for registration[33]/notification,[34] the Commission should allow Member States to decide that priority be determined according to the time at which the application was received (not actual registration). In this scenario, the Member State should ensure that filings of applications must be registered or rejected by the Public Register in the order of receipt.

32 The Commission should ensure that Public Registers make all relevant information available to all parties or their representatives.

33 The Commission should ensure that Member States provide that the responsible Public Register certifying authority should have state indemnity. In the event that such responsibility is delegated to a third party, such party shall be covered by appropriate professional liability insurance for an adequate sum.

34 The Commission should ensure that Member States do not maintain or institute additional 'legalisation'/'validation' requirements, for authentic instruments formally drawn up in other Member States.

35 More generally, the Commission should provide financial support to the EULIS initiative, to enable and encourage its expansion across the EU.

[32] Charge on real property in the sense of this recommendation means the right to extract from the estate the defined and registered amount.
[33] Enrolment with consent of the owner
[34] Enrolment without consent of the owner

II. TRANSFERS OF MORTGAGES BETWEEN LENDERS

(109) It was considered that cross-border lending could be much more efficient if lenders could trade mortgage loans and mortgage securities freely. This could occur in the context of remortgaging, transfer of mortgage portfolios and dealing in mortgage backed securities (MBS).

Main barriers identified

'Accessoriness': the linkage between the debt and the collateral security

(110) In the majority of legal systems in Europe, the link between the principal debt and the collateral is very strictly enforced. Any changes to one have a significant effect on the other. Such a strong link between the loan agreement and the security agreement (i.e. strong accessoriness), does not facilitate changes to either. The result is inflexibility, constituting limited economic freedom for the private customer, as well as an obstacle for lenders. Accessoriness can arise in many ways and to differing extents. It can inhibit the use of mechanisms for refinancing or balancing risk management.

Variety of mortgage deeds

(111) There are a wide variety of mortgage deeds in use across Member States. Some are in a standard form issued by civil law notaries or the Public Register, while in other Member States such as the UK, mortgage lenders use their own form of mortgage deed. This variety can hinder transferability of mortgages.

Lack of ability to pool debts

(112) Some legal systems allow pooling of securities, where the banks participating in a single loan can step in or out without affecting the loan and / or the securities. The English security trust is an example of this. The non-availability of this mechanism constitutes a barrier to more efficient (re)financing.

Lack of Cross-Collateralisation

(113) While it would be possible to encumber more than one property in the same country with a facilitating mechanism such as a Euromortgage (see discussion section below), problems occur when the properties are located in different countries, because of variations in the different national jurisdictions.

Costs caused by transfers of mortgages

(114) Whenever parties to a secured loan wish to change the arrangements, this causes inconvenience, since each change must be evidenced by the lender to the registration authority. This adds to the cost of such transactions.

Discussion

(115) It was recognised during the discussion that some Member States may prefer not to introduce a flexible link between the credit agreement and the collateral security. However, there are already systems in place in some countries such as Sweden, which provide good examples of how a lower accessoriness can work well in practice.[35]

(116) The Forum Group discussed other ways to facilitate transfers of mortgages, focussing on the Euromortgage and the European Security Trust.

(117) The Forum Group considered the Euromortgage to be an alternative tool which could be introduced by Member States, without substantial changes to their existing legal systems, as it would operate under the rule of lex rei sitae. Such a pan-European non-accessory mortgage instrument could:

- avoid burdensome and costly inquiries in other Member States concerning local regulations and the quality of the national mortgage instrument;
- reduce additional and differing formalities and authentication;
- offer mortgage collateral as security for more than one mortgage credit;
- enable easy transfer of the mortgage as well as the property;
- meet the requirements for cross-collateralisation on a cross-border basis;
- meet the requirements for securitisation and mortgage portfolio management; and
- enable the creation of bank syndicates for mortgage finance.

(118) The Forum Group considered that the European Security Trust mechanism should also be encouraged. The European Security Trust would allow a single bank to hold mortgage collateral on trust for all the banks participating in the credit agreement. The position of the consumer would remain unchanged. The security position of the bank participating in the trust and holding tranches of the loan would be protected from the insolvency of the trustee bank, since the trust would be separate from the other assets of the trustee. Only those bodies determined to be suitable by national law (and holding appropriate indemnity cover) could act as trustees. Banks could step in and out of the structure, participating according to their refinancing levels in relation to their rating and to their willingness to take a certain risk or tranche of loans. This would mirror the situation in capital markets.

[35] Due to the flexible Swedish legal environment and well-established practice, there is no need for a third party representative. There, the loan document is not submitted for registration. Instead the landowner asks the land registration authority to register a deed over his real property for a particular amount. He then receives a Mortgage Certificate ("MC"). The MC can be handed to a lender as security for a loan, if in paper form. If the MC is in register form, it is transferred to a lender's MC account with the register authority. Alternatively, it is transferred automatically when the lender applies for an MC (or, in case of changes of lender, from the lending bank to the releasing bank). No intermediaries are involved in this process.

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Recommendations

36 The Commission should ensure that links between mortgage debts and the collateral security are made more flexible. In countries where there is an existing requirement for strong accessoriness between the loan and the collateral, this should be replaced by an accessoriness agreement in the form of a private agreement between the lender and the owner of the mortgaged property. The relationship between the loan and the collateral can be dealt with in such a way as to allow it to be tailored to fit the needs of the parties. [36]

37 The Commission should ensure that Member States allow the lender or any beneficiary of a charge on real property, to appoint a representative (Mortgage Register Representative[37]) vis-a-vis the Public Register. His/her position should be disclosed on the Register and not have any effect on the legal framework of the Register. He/she should be entitled:

- **to establish any abstract of title;**
- **to consent to a change in the respective ranking of charges over the real estate in question and to grant preferential rights between beneficiaries as shall be deemed appropriate;**
- **to consent to, to apply and file any registrations and notifications;**
- **to consent to any change or transfer of the charge on behalf of (and in the name of) the owner of the charge; and**
- **to act on behalf of the owner of the charge in relation to the discharge or cancellation of the charge.**

38 The Commission should explore the concept of the Euromortgage[38], for example by way of a study, to assess its potential to promote EU mortgage credit market integration.

39 The Commission should encourage Member States to increase the transferability of mortgages by introducing pan-European Security Trust instruments.

[36] Any change in the collateral (e.g. sale of property and purchase of a new one), should be possible without fundamentally changing the security package. Equally, more than one property could be used to secure the amount borrowed. All this should be possible without weakening any links between the debt and the collateral.

[37] Changes of mortgage creditors carried out by the register representative without simultaneous registration in the Register will not materially affect third parties interests, because the Register will still show the overall size of all enrolled rights. Changes within the limit of the registered charges do not alter the published content or interfere with protected interests, but represent simply another allocation of pre-existing claims. As the register representative's action may not lead to a material discrepancy between published and de jure existing liens, transparency with respect to size and content of all registered charges will continue to be safeguarded.

[38] See Annex VI for further details.

ANNEX V

THE EULIS INITIATIVE

Property information is held in registers in most European countries.. The individual national land and cadastral registers have evolved to meet the national legal and administrative requirements of the countries they serve. In the EULIS initiative, official land registration organisations from eight European countries have co-operated to develop a pan-European land information service. To date, the initiative has been supported through the European Commission (Directorate General Information Society) *e*Content programme. The aim of the initiative is to demonstrate how a pan-European land information service could be designed to meet the needs of lending institutions and their representatives, and other potential users. In particular, the EULIS initiative seeks to address three major problems that those seeking to access property information held in other countries face: lack of ready access to property information, lack of knowledge about processes in other countries and language difficulties. The project began in 2002 and was completed in mid 2004. It has had a positive response. The participants are keen to develop it further, within the EU and beyond in the rest of Europe.

How EULIS works

Registered land information from national portals will be presented through the EULIS portal. This will be done without altering the information or otherwise processing it in any way, in order to ensure its authenticity. Initially, the register information will be presented in the language of the originating country, with the possibility of including translations in the future. For each country, basic descriptions of legislation and land transactions (including the mortgage, conveyancing and survey processes) are provided. These descriptions have been developed to facilitate consistency and comparability of information from all participating countries. In addition, a list of just over fifty common terms has been developed, with English definitions including reference to particular divergences in national systems.

The service is intended to be easy to access. The EULIS portal will simply be added as an option in the ordinary national service. Thus users will normally need to be registered with one of the participating land information agencies, to comply with any restrictions in information handling.

Assessment of EULIS

EULIS is a practical solution. It recognises the differences between the different legal environments and it enables users to understand and work with them. It provides the basic information required for making secured credit transactions, at relatively low cost and in a relatively short time, thereby also encouraging best practice. It is at a stage of development where further expansion is called for and would be welcomed by all, but without access to funding sources to facilitate such development.

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ANNEX VI

EUROMORTGAGE

Introduction

The term "Euro - Mortgage" or "Euro - Hypothek" is used in many different ways. Here, it is used to represent a security instrument[4] (collateral/mortgage deed), that can be used to encumber properties in a pan-European sense and with greater flexibility of use than that offered by purely domestic security instruments. There are existing flexible domestic instruments such as the German 'Grundschuld' and the Swiss 'Schuldbrief', which have been studied in formulating these views on a Euromortgage.

The Need for a Euromortgage

Consumer Demands

There is an increased need for flexible security instruments, because of a trend towards loans of a shorter duration, and associated desirability in this context to be able to re-use the security, use it for different purposes and to use it across borders.

Market Demands

There is an increased need for flexible security instruments due to the development of a secondary market including MBS (Mortgage Backed Securities), covered bonds and syndication, and also to facilitate effective risk management generally.

Legal Characteristic of the proposed Euromortgage

In order to fulfil the needs of consumers and the market and have the effect of promoting greater flexibility and further integration of the EU mortgage credit market, it is considered that any Euromortgage should have the following characteristics:

- Be decoupled from the loan agreement completely (to avoid the disadvantages o accessoriness explored in the chapter on Collateral Issues)
- Be capable of being used to pledge more than one property
- Be capable of pledging properties across borders
- Be easy to transfer
- Be secure - that is, enjoy a secured position in the event of the insolvency of the mortgage holder

How the Euromortgage should be introduced

Given the pan-European nature of the model proposed, it is considered that the Commission should be responsible for introducing legislation on a Euromortgage, on a minimum harmonisation basis.

[4] The loan agreement is a separate issue to the security tool. It is not explored in any detail in this exposition of the Euromortgage security tool.

The Commission could achieve this by:

- Introducing the Euro-Mortgage as an instrument by way of EU directive/regulation;
- Regulating the Euro-Mortgage through a clear definition of the instrument in the directive/regulation; and
- mandating Member States to introduce any consequential changes required to their legal systems, within clear parameters set by the directive/regulation.

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