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# Legal housing reforms in Europe and in Spain as a results of the international crisis 2007

**Working Paper No. 2/2015**

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This working paper corresponds to the pre-print of the article published at the *Revue de Droit Bancaire et Financière*. Suggested citation: Nasarre-Aznar, S. 'Legal housing reforms in Europe and in Spain as a results of the international crisis 2007'. *Revue de Droit Bancaire et Financière*, No. 2/2015.

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# Legal housing reforms in Europe and in Spain as a results of the international crisis 2007

Sergio Nasarre-Aznar

*Abstract*. This paper covers the causes and the consequences of the worldwide mortgage crisis of 2007 in the field of housing law. The identification of reckless mortgage lending and mortgage securitization as the main causes of the crisis and its spread throughout the rest of the world have reoriented housing law and jurisprudence towards the increase of consumer protection in the field of mortgage loans, both in Europe as well as in Spain. The efficacy of other reforms relating to housing, such as the regulation of rating agencies at EU level or the law of leases in Spain have, on the other hand, been more controversial.

*Keywords*: housing, mortgage, lease, tenancy, tenure, crisis, evictions, foreclosure, homelessness, consumers, securitisation, GSEs, rating agencies.

## 1. The 2007 international crisis: from "home as an asset" to "home as a basic need"

Seven years into the current systemic worldwide crisis, it is evident that housing has taken and continues to take a central role in it.

At the beginning, the main causes for the collapse of the system were the massive widespread of homeownership combined with the moral hazard that entails every mortgage securitisation process[1]. Housing has, nevertheless kept the status of a protagonist within this context till this very day. In the US, the crisis led to an unemployment rate of 10% in 2009 (double the usual rate)[2] and, until 2011, as many as 2.7 million evictions had been carried out amongst those families that had bought their home between 2004 and 2008[3]. Numbers are also dramatic in several EU countries.

This situation has caused numerous changes in both EU as well as individual Member States' legislation, particularly in those jurisdictions that were most negatively affected[4]. The reason for this

[1] See more details at NASARRE AZNAR, Sergio, ´A legal perspective of the origin and the globalization of the current financial crisis and the resulting reforms in Spain`, in. PADRIAC, Kenna (Ed.), C*ontemporary Housing Issues in a Globalized World*, Ashgate Publishing, 2014, pp. 37-50.
[2] See http://data.bls.gov/timeseries/LNS14000000 (last checked on 4-9-2013).
[3] BOCIAN, D. et al., *Lost ground 2011. Disparities in Mortgage Lending and Foreclosures*, Center for Responsible Lending, 2011. Available at http://www.responsiblelending.org/mortgage-lending/research-analysis/lost-ground-2011.html. Last checked on 14-6-2013.
[4] Some of them even expressly forced by the so-called "EU Troika" (European Union, European Central Bank and International Monetary Fund), such as in Greece (*Greece: Memorandum of understanding on specific economic policy conditionality*, 2-5-2010, available at http://peter.fleissner.org/Transform/MoU.pdf) and in Portugal (*Portugal:*

is twofold: States aimed, first of all, to palliate the negative consequences of the crisis, in particular, the loss of the family home (this was achieved, for instance, through the means of moratoria in mortgage enforcements, especially for the most vulnerable; this is the case for Spain with a moratorium from 2012 to 2015) and secondly to introduce legal, structural and financial changes that could prohibit the repetition of such events. The reaction at EU level was the Mortgage Credit Directive 2014/17/EU[5], which is explained in more depth elsewhere in this issue.

The Directive itself reads that "The financial crisis has shown that irresponsible behaviour by market participants can undermine the foundations of the financial system, leading to a lack of confidence among all parties, in particular consumers, and potentially severe social and economic consequences". In any case, this is a process that started with a conception of "home as a financial asset" (to be mortgaged, to be securitised) but which ended with the understanding of "home as a basic need" (i.e. something that could not be easily relinquished by households).

This is why it is vital to understand how the current international mortgage crisis originated, and eventually spread to the rest of the world, not only from a strictly economic perspective[6] but also from a legal one i.e. which key factors in the US mortgage and financial system allowed, or even favoured, the realisation of this phenomenon. A repeat of this crisis may only be avoided if those factors are properly identified and addressed.

Basically, the US mortgage market (both granting and refinancing laws) has been developing for decades in a de-regulated context which even excluded basic norms that are present in any modern system of land credit[7] such as an efficient system of land registration, a strong banking system and a structured system of mortgage securitization. These three axes are central in understanding how such a big housing and mortgage boom was originated during the last decades preceding 2007, the year when the bubble eventually burst.

Thus, reference is being made to the situation in the US of the certainty of land ownership and any consequent charges (i.e. the strength of the loan collateral and of mortgage securities), the banking system (ie. structured banking systems in Europe -*Landschaften* in 18th Prussia, the *Crédit Foncier de France* in 1852 and the *Banco Hipotecario* in Spain in 1872- have been crucial to properly develop the covered-bonds system) and the framework of the mortgage securitization process (without strong mortgage securities -i.e. a system depending more on deposits- there is high risk for negative consequences given rise by the *lending long-borrowing short* phenomenon).
The situation of those three elements in the US at the time when the crisis started was (an still is) as follows:

a) **Land Registry**. The US lacks a unified and federal Land Registry.[8] Some of the existing ones have rules coming from the 18th century while the offices that resemble the European Land Registries the most are the *County Recorders*. Their geographical scope is each county or county equivalent[9], taking into account the fact that there are 3,143 *counties* o *county equivalents* in the

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*Memorandum of understanding on specific economic policy conditionality* of 3-5-2011, available at http://economico.sapo.pt/public/uploads/memorandotroika_04-05-2011.pdf ; last checked on 14-6-2013).

[5] OJEU L 60/34, 28-2-2014.

[6] Many publications have been already devoted to this. A search at Amazon USA of books on "financial crisis" since mid-2007 shows a result of about 800 books, being a bestseller "Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon" of Gretchen Morgenson and Joshua Rosner, New York, 2011, Times Books

[7] NASARRE AZNAR, Sergio, *La garantía de los valores hipotecarios*, Marcial Pons, Madrid, 2003, pp. 29 to 50.

[8] The temptatives by the *National Conference of Commissioners on Uniform State Law* and the *American Law Institute* have been fruitless so far.

[9] In some countries, such in Louisiana, there are no *counties* but *parishes* and in Alaska there are *boroughs*.

US[10]. This geographical diversity is reproduced in the way in which these mechanisms are ruled and operated, which in turn renders registrations or searches within those county-based registries inefficient (in terms of both cost and time) and unreliable[11]. Some authors consider that these county registries are "*a terribly cumbersome, paper-intensive, error-prone, and therefore costly process for transferring and tracking mortgage rights*"[12]. Although their goal is to notify third parties (especially those that aim to make profit and are in good faith), a range of limitations reduce their efficacy, such as different systems of notice[13] or their use in the mere collection of documents rather than titles, which are, moreover, based on the person rather than the property[14]. In addition, many counties have not computerized their registries, meaning that lenders must start their search from the name of the last person who would have enjoyed a valid title on the property and eventually carry a reverse-search up to the name of the borrower (who should be the current owner of the property) in order to verify whether he would have acquired the property legitimately from a third party. Ultimately, the lender would have to trace back until the identification of a valid root of the title in question. A second search would then involve the verification of whether any of the former owners of the property had sold or charged the property to a third party before the current owner, thereby eliminating any possibility that any third party would have any preference or privilege over the right on which the land would be registered[15]. All in all this is a cumbersome process that does not seem suitable enough to continuously transfer millions of mortgages in a short period of time in order to securitise them.

b) The American **banking** system. Its traditional structure is rather weak[16], as it is very atomized and its operations are not diversified enough (either financially or geographically), up to the point that the *lending long, borrowing short* crisis of the last 1980s and first 1990s caused the winding up of 2,000 lending institutions[17]. The three Government-Sponsored Enterprises or GSEs (see Figure 1) were created precisely in order to avoid the important dependence of those institutions on deposits –thereby in the vicissitudes of the local economy– by centralising the mortgage securitization process through the massive acquisition of mortgage loans. These loans would subsequently be grouped and ultimately issued at international level. Since the end of 2007 to April 2010, 129 US banks and Savings and loans (S&L) have been wound up along with 26 credit cooperatives between April 2007 and September 2009[18]. FRANKEL[19] affirmed that the US financial

[10] A quick search in Google of the term "county recorders" (done on 2-8-2014) showed a long list of those county recorders, each one with their own web page, their own requirements for the elaboration of copies, publicity of the records, etc.

[11] PETERSON, Christopher L., "Foreclosure, subprime mortgage lending, and the mortgage electronic registration system", *University of Cincinnati Law Review*, Vol. 78, 2010, p. 1405.

[12] SLESINGER, Phyllis K. and MCLAUGHLIN, Daniel, "Mortgage Electronic Registration System", *Idaho Law Review*, Vol. 31, 1995, pp. 805 and 808.

[13] Some US states are "notice states" as they require that the third acquirer is in good faith and for profit, that is, that he does not have constructive notice of the previous existence of the mortgage. In some states it is also accepted the so-called *inquiry-notice* that is, that the acquirer knows by any extra-registral way the existence of a previous mortgage. And finally, in some others exist the *race-notice*, that is, the acquirer without registral or extra-registral notice registers even before the previous mortgagee (PETERSON, "Foreclosure...", p. 1394).

[14] Most county registers have two index: one with the list of the name of all those who have registered a title in a certain time-frame and another with the name of those who have received a title and have registered it.

[15] Ver el procedimiento en PETERSON, "Foreclosure, ...", pp. 1365 and 1366.

[16] Even during the old good times, between 1921 and 1928, 5.055 banks wound up, while between 1929 and 1932, wound up 5,761 more.

[17] SEIDMAN, William, "The world financial system: lessons learned and challenges ahead", *History of the eighties – Lessons for the future*, Federal Deposit Insurance Corporation, Vol. II, 16-1-1997, pp. 55 to 58.

[18] Source: http://en.wikipedia.org/wiki/List_of_acquired_or_bankrupt_United_States_banks_in_the_late_2000s_financial_crisis (visited, 2-8-2014).

system based on innovation, competitiveness, transparency and control (by the SEC, as regulator of the market), according to the facts, has failed and must be reconsidered.

c) The weak **legal framework of securitization**. During these last years there has not existed a single piece of legislation on securitization in the US, such as, for instance, the *Pfandbriefgesetz* 1899 in Germany. The US securitization has developed rather "freely" – a process which has been facilitated by the patchy and incomplete legal framework dealing with the securitization which basically relies exclusively on the free will of the parties who negotiate these contracts. Thus, in order to allow the GSEs to buy the mortgages from originators and reduce their risk of insolvency (i.e by taking the risk of mortgage default) a certain necessity arose to: i) standardize those mortgages (i.e. to facilitate these transactions and subsequently their pooling through the issue of mortgage-backed securities backed by the same GSEs), ii) reduce their level of quality in order to generalize the loans (and thereby homeownership among the citizens) and, of course, iii) "relax" the regulations in a way that millions of mortgages could be transferred without the need of using either the traditional common law rules (e.g. sometimes, to transfer both the promissory note -the credit- and the mortgage) or the described registration system (eg. the need to register each transfer in the process from the borrower to the special-purpose vehicle which issued the MBS, which seemed to be too rigorous for the financial industry). Something similar happened in the French securitization market with the *burdereau de cession*[20]. The solution for this regulatory lacuna was meant to be MERS[21], a private-owned system of Land Registration ruled by the financial industry, which favoured the so-called "robo-signing scandal" in 2011. Thousands of false documents purporting promissory note transfers were, in fact, forged because MERS could only transfer the mortgage, but not the promissory note. This in turn resulted in a situation where holders of the mortgages were often denied the authorisation to enforce those mortgages against their debtors once these were defaulted[22]. Just as the origination and transfer of mortgages became characterised by a strong sense of uncertainty, the same could be said for GSEs, the "strong legal protection" of the rating agencies' "opinions"[23] and, generally speaking, the constant de-regulation -until the Dodd-Frank Act 2011- of the banking and financial system[24].

Figure 1 illustrates the whole mortgage securitization process in the US, the origination and globalization of the crisis and explains the roles of each participant.

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[19] FRANKEL, Tamar, "Regulating the financial markets by examinations", in MITCHELL Lawrence E. and WILMARTH, (eds.), *The panic of 2008. Causes, consequences and implications of reform*, Edward Elgar Publishing, UK and USA, 2010, p. 219.

[20] NASARRE AZNAR, Sergio. *Securitisation & mortgage bonds: Legal aspects and harmonisation in Europe.* Cambridge, Gostick Hall Publications, 2004, pp. 50 to 53.

[21] *Vid infra.* MERS itself acknowledges that was "created by the mortgage banking industry to streamline the mortgage process by using electronic commerce to eliminate paper" (available at https://www.mersinc.org/about-us/about-us, visited 2-8-2014).

[22] See more details at NASARRE AZNAR,, ´A legal perspective…', pp. 47 to 49.

[23] See a critic of their work at PARTNOY, Frank, 'Overdependence on Credit Ratings was a Primary Cause of the Crisis' in MITCHELL, Lawrence E. and WILMARTH, Arthur E., Jr, *The Panic of 2008. Causes, Consequences and Implications for Reform*. Edward Elgar, Cheltenham UK/ Northampton MA USA, 2010.

[24] *Vid infra*. Alan Greenspan, president of the US Federal Reserve between 1987 and 2006 has always been standing up for the financial de-regulation, which appointed him as one of the 25 responsible of the crisis in the "Time" list (http://content.time.com/time/specials/packages/completelist/0,29569,1877351,00.html; visited 2-8-2014). This contrast with the cover that "Time" dedicated to him in 15-2-1999 in which included him in a "Committee to save the world". At GREENSPAN, Alan, *The age of turbulence*, UK and USA, Penguin, 2008, pp. 524 and 528 he continues advocating, even after the start of the crisis, the banking self regulation and persists in questioning that the Fed could work as a regulator to stabilize the system, though he seems to admit mistakes in his line of reasoning.

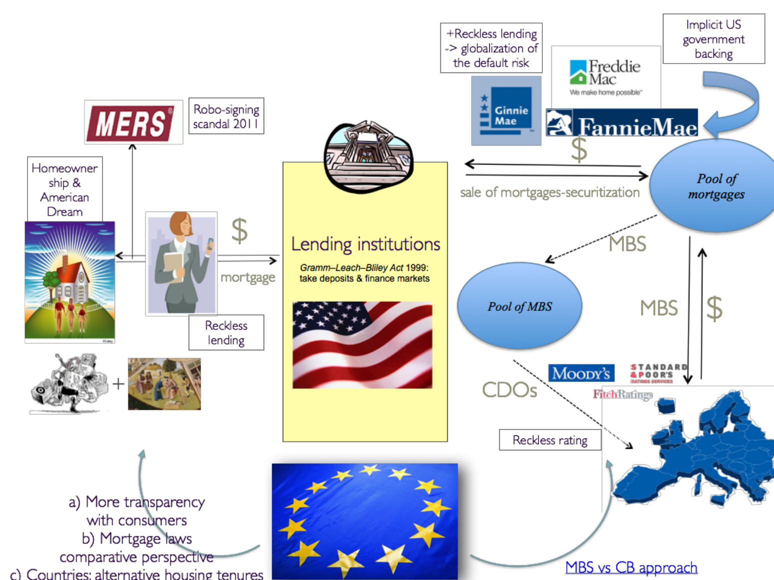


**Figure 1.** Origination and globalization of the 2007 mortgage crisis. Source: own elaboration

The granting of mortgage loans to people without assets, income or even a job (NINJA loans), entailed a high credit default risk which none of the originators had wanted to bear. However, due to the prevalent homeownership policies in place, they hired mortgage brokers to arrange as many mortgage loan contracts as possible and since the remuneration of the latter depended on the number of successful arrangements, reckless lending had been seriously incentivised.

In view of the precedents of the late 1980s and early 1990s that had witnessed the collapse of the US banking industry (the aforementioned bankruptcy of 2,000 credit institutions), the US government pushed forward the creation of three GSEs (Fannie Mae, Freddie Mac y Ginnie Mae) whose specific function was precisely that of buying all the mortgages from originators as soon as they were granted.

Nevertheless, the conveyance of hundreds of thousands or even millions of mortgage loans from originators to only three GSEs (in addition to this “official” mortgage securitization market there existed a private one, which since 2007 has become merely testimonial) could not be undertaken easily due to the aforementioned underdevelopment of the US land registration system. Stakeholders then invented MERS, although this, in turn, only generated further problems.

Moreover, the GSEs were not in a condition to bear the default risk of those millions of mortgages themselves and they consequently perceived the need to securitize them and transform them into securities that were capable -unlike the European covered bonds- to transfer the risk of default of the mortgages to (international) investors. They therefore proceeded to issue mortgage-backed securities (MBS) or even by structuring them by issuing collateralized debt obligations (CDOs) over pools of MBS.

Needless to say, these MBS and CDOs had to be presented in the most attractive way possible since international investors would be assuming the default risk (due to the pass-through system) of the underlying securities (despite their division into tranches which, however, eventually revealed

themselves insufficient in avoiding the writing down losses). Two main tools were used. First of all, the "implicit backing" of the US Government, which was clearly insufficient[25] and, secondly, the use of the private market institutions as "gatekeepers". The latter were namely the three major rating agencies (Moody's, Standard & Poor's y Fitch Ratings) which had, furthermore enjoyed immunity from legal action since the early 1980s, although following the introduction of the Dodd-Frank Act 2011 this has been partially reduced. All of this ultimately led the US government to intervene in Fannie Mae and Freddie Mac in 2004 in order to ensure their viability and those entities that relied on the private ratings ended up lost millions of dollars, such as CALPERs ($800 million of losses in 2006 and 2007) that is currently (2014) suing Moody's and S&P for misrepresentation[26].

Amongst those investors many were European banks, mainly German, French and British, suffered estimated losses (in 2009) of $2.7 trillion[27] at the start of the crash in 2007. Until then, the mortgage securitization system had guaranteed the flow of trillions of dollars from the rest of the world into the funding of mortgages granted to US citizens. This "house of cards", however, fell when originators stopped refinancing existing mortgage loans (particularly those sub-prime mortgages, ie. those with a loan-to-value ratio superior to 80%) due to the dramatic fall in housing prices. Paying current debts with new debts (refinancing) is an essential part of the consumerist system of the US, that is controlled by other three big companies (TransUnion, EquiFax and Experian).

The sudden cease of refinancing caused many mortgage defaults and following the chain of the credit default risk, financial loses were neither shouldered by the originators nor by special-purpose vehicles but they were ultimately paid by MBS investors themselves. British banks lost $31.8 billion, two major Swiss banks lost $62.3 billion and three major German ones lost additional $41.1 billions just until the end of 2008 due to causes that are directly attributable to the US sub-prime crisis[28].

The sudden drop in the value of MBS ("writing down" loses) halted their demand in the international market, thereby ending the source of income of GSEs and the buying of mortgages from originators that were suddenly faced with a liquidity crisis. Major mortgages insurances, such as AIG[29], wound up, thus causing more mortgage loan defaults, increased market overheating, deeper housing price drops, more "walkers" (borrowers in negative equity – i.e. borrowers who owed more than the value of their properties- who defaulted payment, even though they could afford to repay them, due to the possibility of finding a cheaper property in the neighbourhood), and increased weaknesses in the outstanding MBS and CDOs which commenced the spiralling down of the worldwide crisis.

## 2. Reaction at EU level

Prior to 2007, the EU was reluctant on regulating anything in relation to mortgages (even to housing in general) in Europe.

[25] See NASARRE AZNAR,. *Securitisation & mortgage…*, pp. 39 to 49.
[26] See http://www.bloomberg.com/news/2014-04-09/s-p-moody-s-say-calpers-looking-for-ratings-scapegoat.html (visited 22-7-2014).
[27] INTERNATIONAL MONETARY FUND, *Global Financial Stability Report (GFSR)*, April 2009, p. 11 (available at http://www.imf.org/external/pubs/ft/gfsr/2009/01/pdf/text.pdf, visited 30-10-2014).
[28] COX, Jason, FAUCETTE, Judith and VALENZUELA LICKSTEIN, Consuelo, *Why Did the Credit Crisis Spread to Global Markets?*, 2010, p. 18.
[29] Since 2008 to December 2012 was recapitalized by the US Government (See http://www.aigcorporate.com/GIinAIG/owedtoUS_gov_new.html# ; visited 4-10-2013).

Thus, despite the constant efforts, since the 1960's, at creating a eurohypothec (a common mortgage for Europe)[30] little development was achieved at EU level. This is even more relevant when considering that 51% of the EU GDP is composed by mortgage loans, which makes it difficult to understand the idea of "common internal market" if harmonization or, at least, convergence relates only to the other 49%. The Green Paper on EU mortgage loans in 2005[31] asked countries and stakeholders about the idea of the eurohypothec with massive positive answers. Following the White Paper 2007[32], all the goals to be achieved by the eurohypothec were present but the institution itself was paradoxically and unjustifiably abandoned[33].

Since then, seven years of discussions in relation to the mortgage market seem to have ended up in the "de-caffeinated" Mortgage Credit Directive 2014/17/EU which has little to do with the harmonization or convergence of mortgage markets in Europe and more to do with consumer protection, a traditional field of legislation developed by the EU.

In this light, the Directive focuses on several issues, most of them "inspired" in the "Spanish case" (its profound economic crisis). In reality the effectiveness of this Directive depends on the Member States' implementation of certain key aspects such as:

a) Arts. 7 to 9. The standard of behaviour of lenders who must act: "honestly, fairly, transparently and professionally, taking account of the rights and interests of the consumers". This clause begs a series of questions. First of all, is this behaviour going to create a conflict of interest for professional lenders? To which extent are they compelled to disclose the information they would have acquired regarding the mortgage product? Are not professional lenders always going to act according to their own interests –they are there to make profit at the end of the day- rather than the consumers'?
b) Also, if this is required expressly to mortgage lenders, how have they behaved until now? Their staff's remuneration system should encourage this behaviour and they should additionally possess and keep an up-to-date and appropriate level of knowledge and competence "in relation to the manufacturing, the offering or granting of credit agreements". This might run against the policies of some mortgage lenders around Europe that used to prefer marketing-oriented professionals to lawyers or economists
c) Arts. 10 to 16 address the advertising, marketing and pre-contractual information. This, in fact, should not be not misleading although there is no obligation to insert clear-cut sentences to inform about the risk of contracting a mortgage, such as "Contracting this mortgage will cause you to lose your property and part of your other assets". In addition to this, and following the "EU-legislative style", the Directive provides a list of minimum pre-contractual information that should be provided to mortgage consumers, though the efficacy of this is questioned even by the experts[34]. These articles also limit the attachment of financial products to mortgages, a practice which has become very common in Spain since 2008 particularly through credit default-swaps

[30] See more details on this project and how it evolved since then at http://housing.urv.cat/en/cover/research/project/eurohypothec/ (visited 21-10-2014).
[31] Green Paper on Mortgage Credit in the EU. COM(2005) 327 final, Brussels, 19-07-2005.
[32] White Paper on the Integration of EU Mortgage Credit Markets, COM(2007) 807 final, 18-12-2007.
[33] About the eurohypotehc, see NASARRE AZNAR, Sergio, "The Eurohypothec and the Eurotrust: the answers to the goals of the EC White Paper 2007 on the Integration of EU Mortgage Credit Markets", in SJEF VAN ERP et al. (coord.), *The future of European Property Law*, Sellier, 2012, pp. 79 to 122.
[34] See BEN-SHAHAR, O. and SCHNEIDER, C. E. *The failure of mandated disclosure*, "The Chicago Working Paper Series Index", available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1567284 (visited 22-10-2014), p. 64, who affirms that the compulsory disclosure of pre-contractual information "is a history of failure". See also MAROTTA-WURGLER, F. *Will Increased Disclosure Help? Evaluating the Recommendation of the ALI's, "Principles of the Law of Software Contracts"*, 78 (1) University of Chicago Law Review 165, 2011, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2497163 (visited 22-10-2014).

contracted with consumers[35]. The Directive also incorporates the ESIS document, which is a standardized template that provides pre-contractual information. This is, however, quite limited as it does not allow by itself a proper, easily understandable comparative among different bank or product offers.

d) Art. 18. Creditworthiness assessment of the mortgage consumer is, for those countries in which this has not been the rule for years or has been applied very flexibly (such as Spain), the most important provision in the Directive: the consumer may be requested to provide information and this can also be obtained by lenders from private/public databases (art. 20). If there is a "negative prospect" or else the debtor is unable to be rated, the lender *must* refuse the granting of credit. The effects of this rule are, to my view, twofold. First of all, it is foreseen to avoid further NINJA mortgages and this will probably be successful if the information available is good and transparent enough. It must also be said, however, that such preventive measures would hardly be sufficient in avoiding a systemic crisis (*rebus sic stantibus*) such the current one, that is, recent sharp increases in the number of mortgages in arrears and evictions are rather more related to systemic problems such as a high increase of the unemployment rate or the weakness of the Welfare State. Secondly, this rule will not allow numerous households to access homeownership. This is not expected to have many negative consequences in countries where a well-developed tenancy market is in place (eg. Germany or Austria), but it possibly could in countries that due to their decisive shift toward home ownership during the last decades -such as the Mediterranean ones- have seen their rental markets go into considerable decline. Even in the current scenario, "only" 6% of Spanish residential mortgages are in default[36] and a vast majority of retirees are homeowners (with well-paid mortgages) or highly protected tenants (ancient LAU 1964) who have additionally come to their sons' and daughters' rescue where the latter started facing economic difficulties or were even threatened with eviction[37].
e) Consumers should be informed gratuitously (art. 8) although assessment is onerous (and, in accordance with the Directive, should entail more liability on the lender). Art. 19 requires the property valuation to be both professional and independent.
f) Art. 25 could have had a bigger impact in some countries (eg. Germany) if it would have been stricter and more straightforward in establishing a binding right of mortgage consumers to reduce their debt whenever they wished (which should have been a limitation of the principle of *pacta sunt servanda* in favour of consumers). However, it leaves Member States the possibility of establishing this right (either through the contract or by law) along with any compensation for the lender in case it suffered losses due to the (total or partial) early repayment.
g) Art. 28 establishes just weak and general provisions, leaving it up to the individual States to decide:
    a) when mortgage enforcements can start, despite the big disparity that exists in Europe: particularly between the 84 days in Denmark up to the 10 years in Cyprus.
    b) the regulation in relation to default interest rates. In fact it has been recently limited in Spain to 3 times the legal interest rate i.e.12% for 2014. This appears to be a rather questionable approach to consumer protection since default interest rates compensate damages suffered by lenders following default in the loan repayment by the debtor and damages, following the general principle of *restitutio*

[35] NASARRE AZNAR, Sergio. 'Malas prácticas bancarias en la actividad hipotecaria', *Revista Crítica de Derecho Inmobiliario*, nº 727, 2011, pp. 2673 ff.
[36] Census on living conditions of 2011 of INE (National Statistics Institute)
[37] According to FUNDACIÓN ENCUENTRO, *Informe España,* 2013, p. 226, available at http://www.fund-encuentro.org/informe_espana/indiceinforme.php?id=IE20 (visited 16-5-2014), in 2013, 5.5% of the expenses of the elderly were dedicated to their children and grandchildren, 40.4% of the former used their retirement pension to help relatives and friends and 1/5 of all unemployed people live on the pension of an elderly relative.

*in integrum*, should be evidenced by the victim without legal constrains (ie. a similar measure would not be accepted in case of compensation for damages of a car accident).

c) the regulation of the *datio in solutum* in the field of defaulted mortgage loans. *Datio in solutum* means the possibility for the debtor to unilaterally force the full extinction of the loan debt at any time by delivering the mortgaged property back to the lender. There may exist two means through which such policy could be implemented: the "soft" one which entails that parties may agree upon this when the mortgage is created or else when it would be about to be enforced; and the "hard" one, by which the debtor could do it without the need of any prior agreement with the lender since he would be entitled to do so by the law. There are risks in accepting a “hard” *datio in solutum*, as this could imply negative consequences for the mortgage market[38] particularly in respect of prospective mortgagors (it would become both more difficult and more expensive to be granted a mortgage even if certain groups would have already been barred homeownership access)[39].

Even in this latter field of consumer protection, mortgage relationships were, until 2007, expressly excluded from major Directives, such as the Directive 2008/48/EEC[40] on consumers’ credits or Directive 2011/83/UE, 25 October[41], while Directive 93/13/EEC[42] on consumers protection left it up to the Member States whether to extend its protection to mortgagors or not and several jurisdictions, in fact, opted for the latter.

However, the UCTIS Directive (85/611/EEC; 2009/65/EC[43]) might be considered an exception to this trend. According to the Basel criteria, covered (mortgage) bonds benefit from privileged weightings only if they fulfil certain requirements. This does not mean that EU has really implemented the concept of “euro-securitization” of mortgages (see figure 2), which, to my opinion, could be the ultimate goal to achieve a proper “internal financial market”[44].

[38] NASARRE AZNAR, ‘Malas prácticas…”, p. 2712 to 2715.

[39] More expensive mortgage loans, no special interest of current debtors to repay their loans, defaults even when debtors can still pay (walkers), 20% LTV of non-fundable resources to be given by debtor prior to get the mortgage; etc. All these are effects in the 11 non-recourse (no universal liability of the debtor for the mortgage) States in the United States.

[40] Directive 2008/48/EC of the Europen Parliament and of the Council, of 23 April 2008, on credit agreements for consumers and repealing Council Directive 87/102/EEC. OJ nº L 133/66, 22-05-2008.

[41] OJ L 304/64, 22-11-2011.

[42] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. OJ nº L 095, 21-04-1993.

[43] Council Directive 85/611/EEC of 20 December 1985, OJ nº375, 20-12-1985 and Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, OJ nº L 302, 17-11-2009..

[44] See more details on the eurohypothec, the eurotrust and the eurosecuritization at NASARRE AZNAR, “The Eurohypothec …”, pp. 112 and 113.

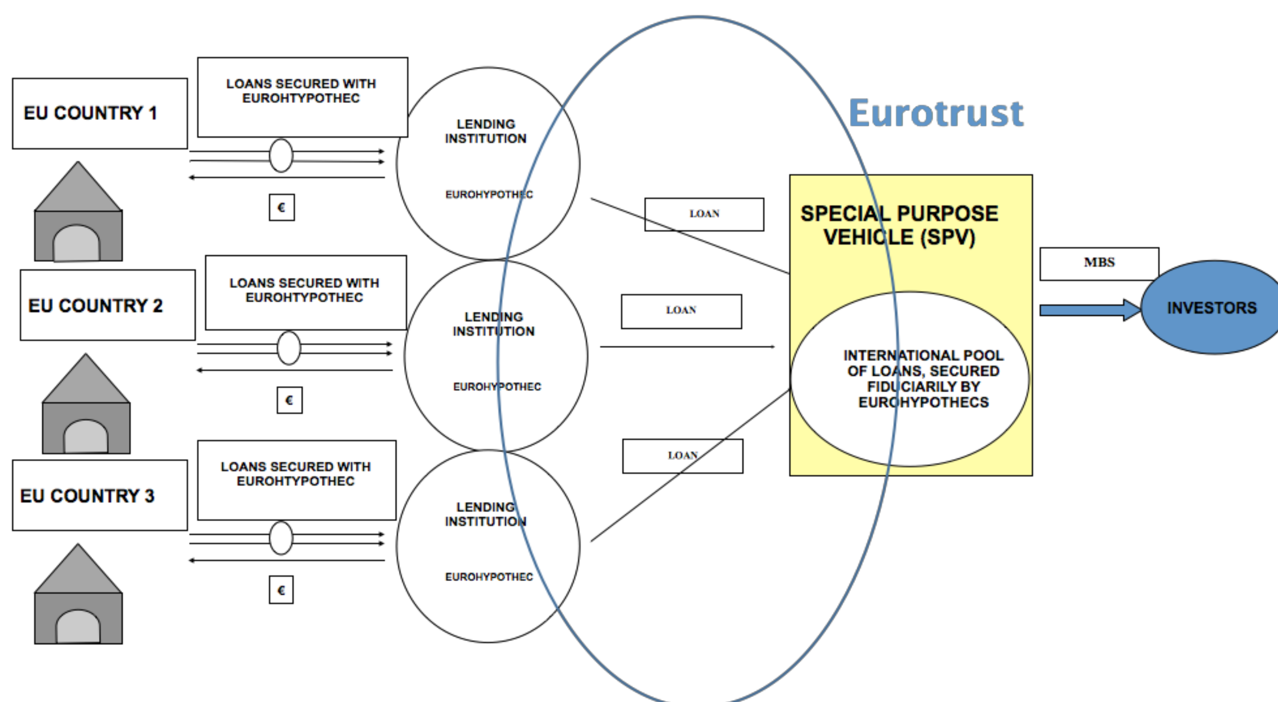


**Figure 2**. The eurosecuritization process, through the eurohypothec and the eurotrust. Source: own elaboration.

On the contrary, in the field of mortgage financing, the single relevant step towards the control and clarification of its legal framework was the EU Regulation 1060/2009, on rating agencies (amended in 2013)[45] albeit at a very limited extent. The Regulation states that: “Credit rating agencies are considered to have failed, first, to reflect early enough in their credit ratings the worsening market conditions, and second, to adjust their credit ratings in time following the deepening market crisis”. Main causes for this are identified: conflicts of interest, quality of credit ratings, lack of transparency and internal governance of credit agencies as well as lack of surveillance of activities carried out by rating agencies. As a result, the Regulation requires that the credit rating agencies’ activities are guided by the principles of: “integrity, transparency, responsibility and good governance in order to ensure that resulting credit ratings used in the Community are independent, objective and of adequate quality”. However, when it comes to address the issue of agencies’ liability for non-compliance, the Regulation leaves this matter to be completely determined according to national laws[46]. It is indicative that no case such as CALPERs[47] in the US, has taken place at European level.

[45] Regulation (EC) 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ nº L 302, 17-11-2009 and Regulation (EU) 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) 1060/2009 on credit rating agencies. OJ nº L 146, 31-05-2013.
[46] See its Explanatory Memorandum, nº 69.
[47] California Public Employees' Retirement System ("CalPERS") v. Moody's Corp., CGC-09-490241 (Super. Ct. Cal., SF County). See some details at http://www.bermandevalerio.com/cases/featured-cases?pid=47&sid=171:calpers-v-moodys (visited don 22-10-2014).

## 3. Reaction at Spanish level

Spain has been adversely affected by the crisis with its unemployment rate in 2013 reaching the level of 25.6%. Youth unemployment stood at a staggeringly higher 54.4%. In fact Spain has been ranked as the second-worst performing Member State behind Greece[48].

Quite surprisingly, however, in June 2014, mortgage delinquency rates totalled up to “only” 6.1%[49]. In comparison, during the same period, other Member States such as Ireland had reported nearly double this rate. Reports have shown that results are even worse in Cyprus, in which 50% of mortgages were defaulted. The mortgage default rate in Spain is deemed to be low due to the mortgage debt restructuring between lenders and borrowers. These restructuring programmes could either be forced by lenders or else agreed by the free will of the parties involved. Another attributable cause can be the tax evasion ratio which in 2012 amounted to 24.6% of the GDP[50] (an increase of 6.8% since 2007), one of the highest rates in Europe[51]. Tenancies are generally not considered to be an alternative to homeownership (and probably neither will they become so, subsequent to the 2013 reform[52]): Spain has the lowest share of tenant-occupied housing in Western Europe (just 12%), which affects both the quality as well as the affordability of the current rented stock[53]. And it must be considered that a healthy housing tenancy market is necessary for a well-functioning housing market or, in other words “the state of development of rental markets as a genuine alternative to home-ownership stands out as a particularly relevant institutional factor shaping the outcome of the housing market and playing a balancing role and alleviating house price pressures”[54].

Approximately 151,000 actual evictions of (defaulted) mortgagors from first residences have taken place from 2010 to 2013, while, in the same period, there were at least 136,000 tenant evictions. The homelessness phenomenon has been substantially palliated through close relative’s voluntary or compulsory (arts. 143 and 144 Spanish Civil Code) solidarity (27.9% of the elderly hosts their sons

[48] According to Eurostat (http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics) in April 2013 Greece scored the highest unemployment rate of EU-27 (27%) followed by Spain.

[49] According to Asociación Hipotecaria Española, *Tasa de dudosidad del crédito inmobiliario. 2º trimestre de 2014* [October 2014], 3.

[50] An important part of it is linked to real estate transactions during the housing boom period. See as an example the phenomenon “dar el pase” (http://www.lavozdigital.es/cadiz/prensa/20070109/temas/contra-fraude-fiscal-pone_20070109.html; checked on 1-6-2013). It consists in organising successive transactions in which the ones in the middle are not recorded nor controlled but only the last one. Another “bad praxis” was to include in notarial deeds a false low price of the sale (to pay less taxes and fees) and to pay the rest directly in cash to the seller (black money) even within the notary public premises. A first try to solve this was Act 36/2006, 29 November, on measures to prevent tax fraud (BOE no. 286, 30 November 2006); the law clearly acknowledged that real estate transactions were an important sector of tax evasion. That reform not only arrived late (2006 was the last year of the Spanish housing boom) but also was insufficient as another recent piece of legislation has been passed (Act 7/2012, 29 October (BOE 30-10-2012, no. 261): a “former unknown” way of fraud was to convey the properties not directly conveying them but through the transfer of securities; now this praxis is taxed as if the property had been conveyed directly.

[51] See SARDÀ, Jordi., *La economía sumergida pasa factura. El avance del fraude en España durante la crisis*, 2014, available at http://cd00.epimg.net/descargables/2014/01/29/323fc63650907548f7491c007d999b03.pdf (visited16-5-2014).

[52] See below.

[53] See more details, under a European perspective, at NASARRE AZNAR, Sergio, “The efficiency of the law of urban leases in Europe”, *European review of Private Law*, 2014, in press.

[54] CUERPO, C. et al., *Rental Market Regulation in the European Union*, EU Commission, DG-Economic and Financial Affairs, Economic Papers 515, April 2014, p. 1.

and daughters, eg. after the latter's eviction[55]) and the vigorous activism of NGOs and the action of the Public Administration.

From the legal perspective crucial changes have taken place in relation to housing. However, whilst legislative action only materialised in 2011, part of the judiciary had already started reacting to bad banking practices (eg. interest rate swaps with consumers). Moreover, some have deemed these reforms insufficient in protecting mortgage consumers or tenants. This caused the rise of the so-called "Robinprudence", ie. judicial decisions with lack or feeble legal basis (eg. decisions based on grounds of equity or general principles of law that, however, clearly contradict the content of the legislative enactments as against the raking of sources laid down in art. 1 of the Spanish Civil Code) that decide to protect the weak party under mortgage or lease or related contracts. Dozens of judgments can be counted from 2010 until 2014 (see one of the most recent at Commercial Court San Sebastián 2-10-2014[56], declaring abusive ie. void a first demand personal guarantee as the judge deemed it excessively burdensome on the guarantor to pay before the debtor, which is, not surprisingly, a common consequence of agreeing upon a first demand guarantee) and their final decisions differ from the result that would be expected for usual mortgage foreclosure or tenant evictions under Spanish contractual, procedural and property laws. This is stirring a certain feeling of uncertainty among key stakeholders (lenders, landlords) leading to potentially devastating results eg reduced international confidence in Spanish banks -which might involve a deeper liquidity crisis- and, in turn, stricter requirements to get a mortgage loan or even a lease for people prospecting to gain access to housing[57].

In relation to enacted laws two main reforms have taken place both in the field of mortgage law as well as in that of leases[58]:

a) Act 1/2013[59] reformed the law on mortgages in relation to first residences of natural persons. Quite paradoxically, however, Spanish last mortgage market reform prior to the one in 2013 consisted in Act 41/2007[60] which did not include any measure to prevent the crisis but to boost it[61]. Anyway, art. 3.1 Act 1/2013 compels all public notaries to underline in the same mortgage deed, the fact that the relationship would be created over a dwelling which is used as residence. This creates the *iuris tantum* presumption that if a dwelling is marked as "residence" in its mortgage deed, it is also presumed to be a "residence" at the time it is foreclosed due to a default under a mortgage. The consequences of being considered a "(first) residence" under Act 1/2013 are many, including: a) default interest rate cannot exceed 3 times the legal interest rate (ie. in 2014 they cannot be more than 12; art. 3.2 Act 1/2013); b) as a result of a mortgage enforcement procedure, judicial costs for the debtor cannot exceed 5% of the claimed amount (art. 7.4 Act 1/2013); c) in case of default, there is a forced decrease of the remaining debt if the residence's forced sale is not enough to cover the whole debt (art. 7.5 Act 1/2013); d) if there are no bidders in the public auction after a mortgage enforcement on a residence, the credit institution can take the property in exchange of 70% (unlike only 50% if it is not a residence) of the theoretical value of the property (arranged in the mortgage deed when the mortgage was granted) (art. 7.10 Act

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[55] FUNDACIÓN ENCUENTRO, *Informe*, pp. 227 and ff.

[56] To be found at *Tirant on Line* TOL4.521.858.

[57] See more details at NASARRE AZNAR, Sergio, "Robinhoodian courts' decisions on mortgage law in Spain", *International Journal of Law in the Built Environment*, in press (2015).

[58] NASARRE AZNAR, Sergio, ´A legal perspective…pp.63-65. See also for the new Catalan intermediate tenures in this same issue GARCÍA, R.M, LAMBEA, N. and MOLINA, E., *The new intermediate tenures in Catalonia to facilitate access to housing*.

[59] Act 1/2013, 14th May. BOE nº 116, 15-05-2013.

[60] Act 41/2007, 7th December. BOE nº 294, 08-12-2007.

[61] Eg. trough the regulation of the reverse mortgage, while it did not foresee any measure to protect mortgage consumers (NASARRE AZNAR, *Malas prácticas*…, p. 2705.

1/2013). In addition to this, art. 8 Act 1/2013 extends the protection of RDL 6/2012 (eg. forced debt-restructuring, forced delays in payments and forced *datio in solutum*) to a wider class of debtors who would be in need of avoiding the mortgage foreclosure of their residence.

b) Act 4/2013[62] reformed the Spanish law on urban leases (LAU 1994[63]). Although containing some interesting additions (eg. introduction of the rehabilitation for rent ie. instead of paying a rent the tenant is allowed to stay in exchange of rehabilitating the property), this reform has substantially reduced the stability of tenants. For instance, there has been a reduction of the compulsory minimum duration of the contract from five to three years and a removal of both the legal right of pre-emption for tenants as well as the referenced prices during the period of protection. Reduced stability for tenants combined with a considerable lack of flexibility (e.g. no partial unilateral sub-letting allowed) and hardly any guarantees for landlords are likely to increase the attractiveness of renting as a form of housing tenure for families.

The Spanish traditional pendulum in relation to housing (*consumers vs mortgage lenders* and *tenants vs landlords*) is today in opposite sides for homeownership and for leases. That is, on the one hand it has to be seen whether more protection for mortgagors (including “Robinprudence”, compulsory negotiation with vulnerable debtors since 2013, reinforced by Act 1/2013 and the prospective implementation of Directive 2014/17/EU) is worth the increasing costs and difficulties in the access to credit for prospective borrowers in need, whilst on the other, whether less protection for tenants will increase the ratio of rented properties in order to allow the development of a true alternative to homeownership and thereby allowing households to avoid overindebtedness.

## 4. Conclusions

Reckless mortgage lending, a deficient legal framework of the US mortgage market and the de-regulation of the US mortgage securitization have been the main causes of the crisis and its consequent spread throughout the rest of the world.

As a reaction, the legal framework related to housing, both in Europe as well as in Spain, have been reoriented towards the increase of consumers protection in the field of mortgage loans.

The efficacy of other reforms relating to housing, such as regulation of rating agencies at EU level or the law of leases in Spain reducing tenants’ protections have been more controversial.

[62] Act 4/2013, 4th June. BOE nº 134, 05-06-2013.
[63] Act 29/1994, 24th November. BOE nº 282, 25-11-1994.

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