THE REVIEW OF THE MORTGAGE CREDIT DIRECTIVE: TOWARD A DIGITAL, SUSTAINABLE AND INCLUSIVE EUROPEAN MARKET

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THE REVIEW OF CRITICAL ISSUES SURROUNDING MORTGAGE CREDIT

CHAPTER 1

THE MORTGAGE CREDIT DIRECTIVE UNDER REVIEW

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I Introduction

Directive 2014/17/EU, of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property, commonly referred to as the Mortgage Credit Directive (MCD), is still a relatively recent piece of legislation. Moreover, most Member States did not transpose on time, with Spain —one of the jurisdictions that suffered most in this area as a result of the 2008 financial crisis— being the latest to implement the MCD in 2019. Evaluating the effectiveness of the Directive is therefore complicated due to the limited availability of data.

However, Art. 44 MCD provided that its review should begin by 21 March 2021. In compliance with this mandate, the European Commisssion's Directorate General for Financial Stability, Financial Services and Capital Markets Union commissioned Risk

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& Policy Analysts (RPA) to produce an Evaluation report, which was published at the end of 2020.[1] The Evaluation report aimed to measure the MCD's effectiveness and appropriateness in order to attain its goals, and it highlighted areas where the EU could develop its powers to a larger extent. It also covered the need for supervision of credit registers, in line with Art. 45 MCD.

The Evaluation report was followed by a Report from the Commission to the European Parliament and the Council on the review of the MCD dated 11 May 2021,[2] which emphasised the already-mentioned limitations of the data obtained due to the relatively short lapse of time since its adoption and transposition, and also as a result of the difficulties generated by the Covid-19 pandemic. A public consultation was launched.[3] In its Report, the Commission stated that it would meet the requirement under Art. 45 MCD to 'submit a comprehensive report assessing the wider challenges of private over-indebtedness directly linked to credit activity' at a later stage, in light of the impact of the pandemic on consumers.

Although in autumn 2024 the Commission's website on the review of the MCD still stated that the adoption of the revised text was expected for the first quarter of 2024,[4] it was not included in the Commission's agenda for the year[5] and the impact assessment was still pending. In late December 2024, the Commission announced that the revision was suspended, but feedback received remained valuable for future reference.

In any event, there have been other significant legislative developments at EU level that most likely anticipate some of the changes to be expected in the realm of mortgage credit. Particularly relevant examples in this respect are the Non-

[1] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission), Risk & Policy Analysts (RPA), 'Report on the Evaluation of the Mortgage Credit Directive' (Luxembourg, Publications Office of the European Union), November 2020. Available at:: https://data.europa.eu/doi/10.2874/41965.

[2] COM(2021) 229 final.

[3] European Commission, 'Call for evidence for an evaluation and impact assessment run in parallel', Ref. Ares(2021)7165942, 22 November 2021 See also the Consultation document at: https://finance.ec.europa.eu/system/files/2021-11/2021-mortgage-credit-review-consultation-document_en.pdf. The responses are available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13090-Mortgage-credit-review-of-EU-rules/public-consultation_en.

[4] See https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13090-Mortgage-credit-review-of-EU-rules_en.

[5] See https://commission.europa.eu/document/download/812f6e9c-15da-4913-8fd2-aea6c26674c0_en?filename=COM_2023_638_1_annexes_EN.pdf.

Performing Loans Directive (NPLD),[6] with regard to credit assignment and reasonable forbearance prior to enforcement, and the revised Consumer Credit Directive 2023 (CCD 2023),[7] especially considering the option to maintain strict information duties, the role of automated decisions during the creditworthiness assessment and the approach towards distressed debtors.

This introductory chapter does not aim to cover all aspects of the MCD that may require attention. It simply aims to describe the matters on which the Commission appeared to be focusing its attention, sometimes querying whether the reveiw should go further (II), and to elaborate on other issues that arise in different Member States represented in this volume and that could be worthy of harmonised solutions, from the perspective of market efficiency but also with the goal of attaining a higher level of consumer protection (III). The chapter ends with some final thoughts that suggest perhaps more holistic approaches than those discussed with regard to concrete mortgage loan issues are required in order to adequately protect consumers, whilst preserving the stability of the financial system (IV).

II The Main Aspects under Review

The Evaluation report and the Commission's report cover in detail a broad range of issues addressed by the MCD or related to it. In light of the public consultation, there appear to be some areas that are of particular interest, including those relating to the scope of the MCD, challenges deriving from digitisation and climate change and the ever-recurring fear of consumer over-indebtedness, which, as a result, may lead to financial instability. This section does not address relevant aspects, such as the use of AI and digitisation toward the conclusion of the contract, including with regard to the creditworthiness assessment, that are carefully considered in the following chapter in this volume.

1 Scope

The Commission's report concludes that, in general terms, the scope of the MCD remains appropriate to meet the objectives of the Directive, although it recognises the need to make certain adjustments.[8]

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[6] Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU.

[7] Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC.

[8] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 10.

In particular, the Commission considers that the exclusion of equity release schemes as per Art. 3(2)(a) MCD may result in an insufficient level of protection for consumers. The reasons for excluding these products, as explained in Recital 16, do not seem solid: although pre-contractual information should be slightly different and the creditworthiness assessment is irrelevant, where there is in effect a reverse mortgage, there is credit secured by residential property, regardless of the fact that maturity does not occur, typically, until the consumer dies. A different matter is that of home reversion plans and other similar products, which do not involve the provision of credit; although some make the case to include them as well,[9] this would entail broadening the scope of the MCD considerably, probably pushing its boundaries too far. It is undeniable that both types of product (i.e. those involving credit and those that do not), pose similar problems insofar as the target consumer groups are particularly vulnerable to misinformation (not necessarily due to age, but because they are encountering difficulties to make ends meet and therefore may make rash decisions) and they are often what under normal circumstances would be considered 'a bad investment'. However, the MCD is a piece of legislation on credit, as defined in its Art. 4, and there does not seem to be a reason to depart from this, given the confusion it would generate. Nevertheless, it should be noted that the potential inclusion of reverse mortgages in the MCD is without prejudice to the desirable design of legal frameworks, at EU and/or domestic level, that protect consumers of this kind of products whether they include the provision of credit or not. The lack of such a general framework could lead to opportunistic decisions; i.e. professionals offering non-credit products only, in order to escape more stringent rules on reverse mortgages or choices based on diverging taxation rules, rather than on the convenience of a given product.[10]

The Commission's report also refers to unsecured loans for property renovation. These are now covered by CCD 2023 (Art. 2(3)), even if they exceed EUR 100,000 (instead of the previous 75,000). However, consumer credit for purposes other than acquiring or retaining property rights over immovable property (e.g. consumer credit to pay for holidays or medical bills) secured by non-residential immovables continue to not be covered either by the MCD or by the CCD 2023.[11]

The Commission considers the need to monitor the emergence of new entrants, including non-bank lenders and in particular, peer-to-peer platforms, and their possible classification as credit intermediaries, a matter that is specifically discussed in the second chapter of this volume. Suffice it to say here that in most Member States covered in this volume, currently mortgage credit does not appear to be concluded via

[9] See Del Pozo Carrascosa in Chapter 3 of this volume.

[10] Anderson, (2021) 187 ff.; Arnaiz (2021) 209 ff.

[11] Arroyo Amayuelas (2024) 6.

such platforms, with the (notable) exception of France. However, most contributors foresee that this may change rapidly, and that diverging regulatory approaches may emerge. In Ireland, the number of crowdfunding service providers is growing, but they do not as yet facilitate mortgage lending to consumers. The review of the MCD should certainly take this possibility into account. On a more general level, the appearance of non-banking lenders, often mortgage loan assignees, has led to the 'mortgage prisoner' issue in Ireland (and in the United Kingdom), generates problems in the Netherlands, and conflicts escalate when the new holder of the credit does not fall under EU legislation, as shown by the chapter on Romania. This issue, and potential remedies, will be discussed in a little more detail below (section 6).

Another aspect highlighted during the preliminary review stage was that only Finland used the opt-out provided for in Art. 3(3)(a) MCD and only the UK used the option to exclude 'buy-to-let' agreements as per Art. 3(3)(b) MCD, which might be read as an indication that these exclusions are not necessary in most Member States, although it is more likely to be the result of rushed and minimal-effort transposition in most of them.

There is another matter concerning Art. 3(1) MCD that should be taken into account: its wording is cryptic. Whilst subsection (a) is probably understandable in all Member States, as long as 'secured by a right related to residential immovable property' refers to a *ius in rem,* subsection (b) is problematic. According to the latter, the MCD applies to 'credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building'. A problem arises from the use of the expression 'property rights', which has a clear meaning in common law systems that is lost when, as in the French, Spanish and Italian versions, it is transformed into 'rights of property'. This expression has no legal meaning whatsoever in said jurisdictions and it suggests the idea of ownership, thus excluding other possible property rights that may be acquired or retained over an immovable. Moreover, the central —and undefined— concept of residential property is absent from this subsection, thus suggesting that a credit agreement the purpose of which is to retain ownership over a piece of rustic land or parcels of land destined to industrial purposes may be covered by the MCD. Also, and no less importantly, in subsection (b) the notion of 'security' disappears: what matters is the purpose of the credit agreement and not that the loan is secured by a mortgage or other similar security right. The land or construction is not necessarily collateral to the credit.

And yet, the MCD seems to have been drafted with only mortgages in mind: the provisions on the creditworthiness assessment, which must not rely predominantly on an increase in value of the property (Art. 18), and those on enforcement (Art. 28), are clear examples of this. The question arises as to whether the MCD applies or should apply to other financing mechanisms that may have a role in the market. An illustrative case is that of deferred payment guaranteed by a resolutive condition whereby, in the event of default, the vendor recovers ownership of the residential immovable property. It can be argued that, insofar as it is acting in the course of its trade or business, a developer, for instance, falls within the concept of 'creditor' as per Art. 4(2) MCD, and the agreement meets the definition of 'credit agreement' provided by Art. 4(3) MCD.[12] However, it is difficult to see how the ESIS or the rules on creditworthiness or on enforcement can encompass such financing systems. In France, the mortgage granted to the vendor of immovables may not pose problems with regard to enforcement; however, the fact that the contract between the vendor and the buyer is not a loan contract, but rather a sale contract, also creates difficulties when considering the application of the MCD. Adjustments in this respect would be welcome, since arrangements of this kind may be beneficial to consumers as there is no third party providing credit. Caution is required to avoid unfair practices arising in this area as well.

2 Advertising, Pre-Contractual Information and Unfair Terms

The Commission's report, drawing from the Evaluation report, concluded that although the provisions on advertising (Articles 10 and 11) and on pre-contractual information (especially, Articles 14 and 17) had managed to enhance consumer protection by providing information that allows borrowers to compare offers, consumers do not always understand the meaning of such information (e.g. on the APRC), and that they may be overloaded by information or receive it too late, all of which makes it more difficult to compare products. Moreover, the ESIS does not appear to be well suited for the provision of information in digital form. Stakeholders also stressed that complying with advertising and pre-contractual information duties in digital contexts is difficult and generates problems and costs that perhaps outweigh the benefits to consumers. The challenges posed by digitisation are addressed in the next chapter of this volume and, in chapter 4, the issue of transparency is analysed from an economic point of view. Therefore, here it suffices to briefly touch upon four issues.

First, the EU legislature is well aware of the risks attached to information overload for consumers. Nevertheless, the CCD 2023 not only maintains the approach according to which the provision of adequate information allows consumers to compare and make reasonable decisions, but it also increases the amount of information to be conveyed to the borrower.[13] It would be a surprise if the revised MCD did not follow a similar path, especially bearing in mind that, as already stated, peer-to-peer lending

[12] See also Art. 2(2)(h) CCD 2023, where deferred (and unsecured) payments are only excluded when they comply with certain stringent conditions, i.e. when they are interest free and payment is due within 50 days of the delivery of the goods. Therefore, even if there is no interest due, if payment is deferred for more than 50 days there is credit and the CCD 2023 applies —although Member States may opt out of this as per Art. 2(8)(b).

[13] Arroyo Amayuelas (2024) 7-8.

and other digital platforms do not appear to be establishing themselves at high speed as relevant actors in the mortgage/immovable security market. However, deferring the decision on the regulation of these situations will probably result in the need to review the MCD again sooner rather than later.

Second, the APRC, which is not put into question by the legislature, may not play such a stellar role towards the protection of borrowers as anticipated. This is mainly because consumers may not understand that the APRC is only relevant to compare offers of the same type of credit and for the same duration, and even then, factors such as the addition of insurance premiums may affect the APRC, as explained in the chapter dedicated to Belgium in this volume. It is clear, for instance, that an interest-only mortgage is more expensive, in the long term, than a regular mortgage where the principal is being repaid monthly and thus ceases to yield interest, and yet the APRC will be lower for the former. Moreover, there are other factors to be considered. For instance, the costs that may be payable up front are often understood to be part of the down payment by the consumer, who has saved an amount to that effect. Once the initial costs are covered, the consumer wants to know how much the monthly instalments will amount to, and the creditor is also interested in the consumer's ability to meet them, as part of any responsible borrowing/lending operation.

Third, it is worth mentioning that a higher level of consumer protection would be desirable with regard to the reflection period and/or the right of withdrawal (Art. 14(6) MCD), given the duration of mortgage credit agreements and the consequences for the consumer in the event of default. Curiously, the Evaluation report found that consumers felt they are not given enough time to reflect, more so even than prior to the implementation of the MCD. Perhaps one of the problems is that the MCD merely provides that the pre-contractual information needs to be provided 'in good time' before the consumer is bound by the contract (Art. 14(1)(b) MCD),[14] which is a very loose expression. Unfortunately, it has been copied into a number of domestic pieces of legislation, perhaps for fear of not adequately respecting the mandatory harmonisation.

Finally, it is striking to note the very different perception and application of the Unfair Contract Terms Directive (UCTD)[15] to mortgage credit agreements in different Member States. For more than two decades, there was very little litigation in this respect. Somehow, mortgage loans were not viewed in the same light as other consumer loans, probably because they appertained to the (untouchable) realm of banking law. This was, of course, a misconception. The effects of the 2008 financial crisis, especially in Spain, led to an array of ECJ decisions dealing with unfair contract terms in mortgage agreements. As a result, the duration of enforcement proceedings

[14] See now, also, Art. 10(1) CCD 2023.

[15] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

has more than doubled and the legislature has put in place mandatory rules on default interest and on early acceleration, and has ensured the notary's involvement prior to the conclusion of the contract, all of which is aimed at barring future claims based on unfair terms. This process, however painful, has contributed to 'sanitise' Spanish mortgage contracts, without prejudice to new unfair terms arising in the future. By contrast, in other systems, it is recognised that legislation on unfair terms may provide better remedies for the consumer than the MCD itself. This is the case in the Netherlands, with regard in particular to compensation for early repayment, especially where the MCD and implementing legislation are not applicable because of when the payment took place. From a completely different point of view, the experience in Poland also shows the courts' reluctance to apply the UCTD in the context of foreign currency loans, and a similar result is found in Romania, due to procedural barriers to the effectiveness of the UCTD. Thus, whilst some jurisdictions have made significant progress in the level of consumer protection thanks to the UCTD and the ECJ decisions, in others reluctance to interfere with banking practices seems to endure, despite developments at EU level.

3 Bundling and Tying Practices

The MCD generally allows bundling, but not tying, although there are a few cases where the latter is accepted (Art. 12).

One of these exceptional cases where tying is possible concerns opening or maintaining 'a payment or a savings account, where the only purpose of such an account is to accumulate capital to repay the credit, to service the credit, to pool resources to obtain the credit, or to provide additional security for the creditor in the event of default'. This is probably reasonable, but the standard requirement of maintaining a servicing account may entail costs for the consumer although its main purpose is to facilitate the lender's job. For this reason, prior to the MCD, the supervising authority in Spain had provided that such accounts should be free of charge. Paradoxically, as a result of the MCD, this has ceased to be the case. Instead, the Polish legislation still guarantees that these accounts should not entail costs for the consumer. Although it would lead to a loss of income for the lenders, if the review of the MCD aims at enhancing consumer protection, stating that accounts required by lenders should be free of charge would be a step forwards in the right direction.

Another instance where tying is allowed concerns payment protection insurance (PPI). On paper, products designed to protect consumers from defaulting in the event of retirement, death or job loss should be beneficial to both parties. However, in practice, it may be the case that PPI products do not cover situations considered at 'high risk', such as psychological illness or illness due to pre-existing medical conditions or unemployment after a certain age. As stated by consumer associations during meetings carried out in the context of the review of the MCD, this results in an over-priced product with limited or no value in terms of insurance coverage. This explains, for instance, why Poland has not allowed tying practices as per Art. 12(2)(b)(c) and (3) MCD, and the information requirements for bundled products can be deemed to gold plate the EU provisions. Also, it appears that pre-ticked boxes and aggressive sales practices are a frequent occurrence, even if an insurance product, for instance, is presented as bundled (and not tied). This is most likely prompted by the high commissions that banks receive as a percentage of the insurance premium if this is provided by a third party, the incentives for staff to place such products and the fact that sometimes lenders design mortgage loans that would not be profitable without the bundled products.[16]

These are all indicators of bad business practices, which the MCD could contribute to eradicating. Perhaps unsurprisingly, the Evaluation report found that bundling practices had increased in a similar proportion as to that in which tying practices had decreased as a result of the MCD.[17]

4 Responsible Lending and Promoting the Uptake of Green Mortgages

One of the goals of the MCD was to enhance responsible lending, and it endeavoured to do so by laying down provisions on the creditworthiness assessment and its effects on granting credit. Whilst more stringent conditions in this respect may have excluded some sectors from accessing credit (and thus, perhaps, from adequate housing), it is still obvious that lending only when there is a reasonable expectation that the borrower will be able to meet the obligations arising from the contract is beneficial to both consumers and lenders, and that it facilitates financial stability. This is still an ongoing debate, while other pressing matters need to be addressed: the energy renovation of the very obsolete European building stock is one of the EU priorities when it comes to mitigation and adaptation to climate change. Taking the energy efficiency of the collateral into account within the creditworthiness assessment is one of the possibilities when considering the potential role of the MCD in promoting the uptake of green mortgages.

4.1 The Creditworthiness Assessment under Review?

A *pièce de resistance* of the MCD is Art. 18 and, more specifically, the prohibition to grant credit if the creditworthiness assessment is negative, i.e. if there is not a reasonable expectation that the consumer will be able to meet the obligations arising

[16] On such matters, see the thematic review by the European Insurance and Occupational Pensions Authority and the warning it issued to insurers and banks, which are available at: https://www.eiopa.europa.eu/publications/warning-insurers-and-banks-credit-protection-insurance-cpi-products_en

[17] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 123 ff.

from the credit agreement. It appears that the MCD may have forced Member States to change their legislation to this effect (e.g. Portugal, Spain). Although the rule raised criticism because more stringent solvency controls may exclude consumers, particularly young home buyers and vulnerable sectors of the population, from access to credit (this appears to be the perception in Ireland, Lithuania, Portugal and the United Kingdom, for instance), for others it does not seem to have as relevant an impact as housing affordability itself (the Netherlands).[18]

The MCD does not explain what consequences derive from lack of compliance with this provision. It certainly does not lay down private law remedies, which are left to domestic legislation. Some Member States have expressly opted to sanction the lender with loss of interest; in others, there is an ongoing discussion as to what the private law solution should be, since nullity of the agreement may leave the consumer in the non-desirable situation of having to return the loan immediately, despite having invested the money. Although perhaps it may be deemed to exceed the EU's powers, clarification in this respect would be advisable. Perhaps the Czech model, where the law in this respect departs from the general rules in the Civil Code and thus nullity of the mortgage loan does not entail immediate restitution of the principal, could be considered.

As for the information upon which the creditworthiness assessment is to be based, Art. 18 MCD does not define what data should be gathered by the lender. It merely states that the creditworthiness assessment must rely on factors relevant to verifying the prospect of the consumer meeting the obligations arising from the agreement, which would suggest that only financial information is relevant. Art. 20 MCD further confirms that the assessment 'shall be carried out on the basis of information on the consumer's income and expenses and other financial and economic circumstances which is necessary, sufficient and proportionate'. This, together with the fact that the assessment must be carried out in the interest of the consumer, to prevent irresponsible lending practices and over-indebtedness, is now expressly mentioned in Art. 18(1) and (3) CCD 2023. The latter also provides examples of data that should be taken into account and excludes special categories of data referred to in Article 9(1) of Regulation (EU) 2016/679, as well as recurring to social networks as external data. During the review of the MCD, the financial sector was in favour of keeping the Directive principle-based in this regard. Hopefully, the revised MCD will at least clarify that the creditworthiness assessment should be carried out in the consumer's interest and adopt the innovations introduced by the CCD 2023. It is less likely for the MCD to go much further. However, the risks of profiling are not limited to information obtained via social networks. The MCD should factor in other

[18] See, however, in the Netherlands, the rather lax regulation on LTV limits and, for Ireland, the combination of restrictive rules with high property prices that would explain exclusion from the market. The regulation in Lithuania appears to boast some of the strictest LTV and DTI ratios.

possibilities of profiling arising from the use of AI and, if need be, amend the CCD 2023 to this effect.

The CCD 2023 also responds to the uncertainties highlighted by the Commission's report on the review of the MCD as to how the creditworthiness assessment should be carried out when there is more than one borrower, by providing that the assessment should be made on the basis of the consumers' joint repayment capacity. Given how recent the CCD 2023 is and that the consultation was run in parallel, it is to be expected that the revised MCD will adopt the same criteria, also with regard to the already mentioned use of AI and other automated processes, and the right to obtain explanations on the reasons behind the result.

As was already the case in Art. 18(6) MCD, the CCD 2023 also provides that the consumer's creditworthiness will be reassessed every time there is a significant increase in the total amount of credit granted (Art. 18(10)). Perhaps surprisingly, however, according to Art. 35(1) CCD 2023, 'creditors shall not be required to perform a creditworthiness assessment in accordance with Art. 18 when modifying the existing terms and conditions of a credit agreement in accordance with the third subparagraph, point (b) of this paragraph, provided that the total amount payable by the consumer is not significantly increased when modifying the credit agreement'. This means that the creditworthiness assessment needs to be carried out when totally or partially refinancing, but not when the terms of the credit agreement are modified in the context of forbearance prior to enforcement, insofar as the amount of the loan does not increase substantially. Leaving aside that it is difficult to determine what a 'significant increase' is, it should be noted that measures such as a change of type of credit agreement or deferred payments or payment holidays or even an extension of the term, may have an impact on the consumer's repayment capacity (in the latter case, for instance, if it takes the consumer into retirement). Curiously, the NPLD introduced in the MCD (Art. 27a) and in Directive 2008/48/EC (Art. 11a) rules designed to protect consumers if the terms of the credit agreement are amended, precisely because consumers may find themselves in a situation of dependency where their bargaining power is exponentially reduced. Undoubtedly, this will be even more so the case if they are undergoing financial difficulties that may lead to enforcement. The relaxation of responsible lending rules prior to enforcement, as per Art. 35(1) CCD 2023, may determine changes in the approach of supervising authorities in certain Member States, such as Belgium, where the modification of contractual terms is subject to strict conditions, thus rendering it very difficult for the parties to voluntarily reach forbearance agreements, which means that they then revert to informal solutions, leaving borrowers, in effect, at the lenders' mercy.[19] Including more lenient provisions, however, is a matter that requires careful thought, since

[19] See the chapter on Belgium in this volume.

forbearance measures should always be viable (see below 7.2). The review of the MCD certainly provides an adequate space for reflection.

4.2 Green Mortgages and whether the MCD May Contribute to Decarbonisation Goals

Green mortgages are designed to finance the purchase, construction, or renovation of residential and commercial properties with high energy performance or where this is significantly increased.[20]

Energy efficient mortgages (EEM) are purported to benefit all parties concerned: borrowers, through lower interest rates, reduced energy bills and increased property value, and lenders, by lowering default risks and capital requirements.[21] They also aim to contribute to economic growth and environmental targets, such as those established, recently, by the new Directive on the energy performance of buildings.[22] The EU embraces EEMs as part of its Renovation Wave[23] within the European Green Deal,[24] comprising multiple legislative and non-legislative initiatives.[25]

The Commission's public consultation within the process of reviewing the MCD expressly included as a preliminary problem the need to support the uptake of green mortgages. The Evaluation report had found that although the Directive does not pose barriers to green mortgages, stakeholders believed that there is potential for growth and it is suggested that a possible incentive would be to take energy efficiency considerations into account during the creditworthiness assessment, because the

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[20] See the Energy Efficient Mortgages Initiative, 'Definition of Energy Efficient Mortgage', 14 November 2018, where a 30% improvement in the energy efficiency of the building is considered significant. Available at: https://energyefficientmortgages.eu/wp-content/uploads/2021/07/EEMI-Definition-14.11.18.pdf.

[21] Inter alia, see Energy efficiency Data Protocol and Portal (EaDPaP), 'Final report on correlation analysis between energy efficiency and risk (D5.7)', 26 August 2020; Directorate General for Energy (European Commission), 'The quantitative relationship between energy efficiency improvements and lower probability of default of associated loans and increased value of the underlying assets : final report on risk assessment' (Luxembourg 2022, Publications Office of the European Union).

[22] See Directive (EU) 2024/1275 of the European Parliament and of the Council of 24 April 2024 on the energy performance of buildings (recast)

[23] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, "A Renovation Wave for Europe - greening our buildings, creating jobs, improving lives"', 14 October 2020, COM/2020/662 final.

[24] See https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en.

[25] In further detail, on the topic addressed in this subsection, Anderson (2023).

borrower's income will go further if utility bills are lower and thus, as already stated, the probability of default is lower.[26] The same report, however, mentions that some associations representing creditors do not agree with the inclusion of detailed prescriptions of such nature in the MCD, and that the design of sustainable financing products should be left to the parties concerned. However, the Evaluation report also found that the lack of definition of 'green mortgages' and 'energy efficiency' makes data collection difficult and poses the risk of the term being used as a marketing tool (greenwashing). In response to the Commission's call for technical advice on the review of the MCD, the European Banking Authority (EBA) considered that the MCD has a neutral effect on the uptake of green mortgages but recommended the adoption of a harmonised European definition thereof.[27]

Although the EEMI describes the green mortgage 'ecosystem' as a 'virtuous circle'; i.e. a win-win scenario for all parties concerned, and a positive impact on the planet, there is still a number of fundamental issues that cannot be addressed by private law measures alone. The affordability and the effectiveness of green mortgages may not be as straightforward as envisaged.

In this regard, research backing the green mortgage initiatives shows that there is a correlation between green mortgages and a lower risk of default, together with an increase in the value of the property.[28] Naturally both aspects benefit lenders and borrowers. Two main reasons are given to explain this negative correlation between green mortgages and default. The first is that the borrower's income goes further as less of it is dedicated to cover utility bills (the 'energy savings effect'). This is probably true in many cases. However, as with any fast-evolving technology, the risk of obsolescence is high, and, as a result, the increase in value of the property, which is also a key factor in the design of EEMs, may be short lived. Therefore, a loan that is considered 'green' today, may not be in a few years' time. Moreover, consumers (and lenders) are uncertain as to whether improvements to a property will result in a better Energy Performance Certificate, or whether they will have any real effect at all. The second reason for the positive link between EEMs and performance of the mortgage loan as planned raises concerns: households with higher incomes can afford more expensive properties (or investments in improving existing ones). This is sometimes referred to as the 'income selection effect'. The expression illustrates the fact that only those with higher incomes are in a position to buy newer, more efficient properties,

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[26] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 15.

[27] EBA, 'Opinion of the European Banking Authority on the European Commission request for technical advice on issues related to the Mortgage Credit Directive', 23 June 2022, 23. See also, from the perspective of consumers associations across Europe, BEUC, 'Affordable green loans: getting consumers on board of the green transition', 14 September 2021, 4-6.

[28] Inter alia, Kaza *et al.* (2014), 279–298; B. Guin & P. Korhonen (2018) and (2020).

or to extensively renovate their existing ones to render them energy efficient. Higher and regular incomes should naturally be less prone to default in any event. On the other end of the equation are those with lower incomes, who will not be able to afford an energy-efficient property and, if they can access credit at all, they will be offered loans with comparatively higher interest rates. Coupled with expensive utility bills, it is not surprising if such mortgages are more likely to be in arrears. From this perspective, green mortgages may have the unintended consequence of increasing the poverty gap, leaving some sectors in a 'vicious circle' where renovation of the building stock is unthinkable without public funding.

The question arises as to whether, as has been suggested, energy efficiency should be taken into account during the mortgage loan underwriting process. Of course, the energy efficiency of the property should be taken into account at the time of appraising it,[29] as a natural consequence of having reliable valuation standards in place (Art. 19 MCD). A different question is whether a rigorous appraisal will serve its purpose in a context of rapidly evolving technology. However, the matter under discussion during the review of the MCD is whether the energy efficiency of the property should also play a role within the creditworthiness assessment itself.[30] This would have the effect of rendering mortgage loans more accessible to those buying energy efficient properties or renovating to improve the energy efficiency of the building. It would probably lead to an increase in the uptake of EEMs.

According to Art. 18 MCD, the creditworthiness assessment shall rely predominantly on the expectation that the consumer will be able to meet the obligations arising from the agreement. Therefore, higher incomes coupled with lower interest rates and lower utility bills due to the energy efficiency of the property should lead to better credit scorings. Nevertheless, the assumption that a more energy efficient home will be cheaper to maintain should not be exaggerated, due to the risk of obsolescence, the volatility of energy markets, the ever more changing climate and the occurrence of systemic crisis.

Art. 18 MCD provides an exception to the general rule whereby the creditworthiness assessment may rely predominantly on the increase in value of the property when the purpose of the credit agreement is to renovate the building. Naturally, this covers mortgages taken out to improve the energy efficiency of the building. Nonetheless, the assumption that the property's increase in value will last should not be made

[29] See EBA, 'Guidelines on loan origination and monitoring, Final Report, EBA/GL/2020/06', 29 May 2020, para. 208.

[30] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 92 ff.; EBA, 'Opinion of the European Banking Authority on the European Commission request for technical advice on issues related to the Mortgage Credit Directive' 6.

lightly, for the reasons already mentioned. Perhaps it is more a case of investing now so that the property does not lose value in a relatively short lapse of time.

It should be noted that Art. 18 MCD does not preclude taking energy efficiency into consideration and, in fact, this aligns perfectly with its underlying principles. Lenders should consider such factors in the same way as they consider the location or the quality of the construction, for instance. However, in any event (i.e. even if the collateral is valued higher), the advantages in terms of better scorings for the purchase of energy-efficient properties need to be set against the amount of the loan, which will in many cases be higher due to the higher value of the property (or of the planned renovation).

The experiences of the different Member States represented in this volume vary. It is probably safe to say that 'green mortgages' by themselves have not, for now, caused major changes. New lending regulations in the Netherlands, which link the maximum amount of the loan to the property's energy efficiency label, will be interesting to monitor. Ireland stands out as an example of a high uptake of green mortgages, which in 2022 accounted for about a third of all mortgage lending. However, this may be at the cost of excluding lower-income borrowers from access to credit to finance more energy efficient housing and questions arise as to whether the focus on energy efficiency ratings in the mortgage market alone is sufficient, given that it does not translate intro environmentally impactful lending practices. At the other end of the spectrum, in some systems the interest rate reduction is so low that advertising this type of mortgages as EEMs is probably an instance of greenwashing. For example, in Spain the interest-rate reduction is of 0.10 to 0.30 points if the property obtains an energy efficiency level grade A or B.[31] For most old buildings, this entails major works and often unaffordable expense. In Hungary, there is no price differentiation between green and non-green loans. In Belgium, renovation projects may be financed through green loans, but these are rarely secured by a mortgage due to the relatively low amounts and short duration; perhaps other incentives, as well as lower interest rates, are needed promote the uptake of green mortgages, especially for large renovation projects.

In any event, it is relevant to emphasise that Art. 18 MCD was designed to hinder over-enthusiastic lending. Perhaps lenders actually do bear the above-mentioned risks in mind, despite the renovation vibe in the air. And consumers are weary of the uncertainties as to the actual benefits of higher standards of energy-efficiency, as well as fearing over-indebtedness (i.e. exactly what the EU consumer protection legislation

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[31] See the observations made by the Spanish consumer association Asufin in its December 2020 study, where it was also found that often green mortgages were more expensive than mortgages promoted by lenders aiming to place bundled products: https://www.asufin.com/wp-content/uploads/2020/12/ESTUDIO-FINANZAS-VERDES_maq_ingles.pdf.. Also, EeMMIP, 'Literature review of the energy efficiency gap', 30 November 2020, 8.

has been promoting for decades now).[32] For some consumers, access to energy efficient homes or renovation of the existing one is simply out of reach, hence why the EU Commission acknowledges that other solutions are necessary.[33] Green mortgages may promote higher energy efficiency standards for those with sufficient financial means, which is of course positive, insofar as there are alternatives for those who, otherwise, would be left behind. The implementation of the 2024 Directive on the energy performance of buildings will no doubt reignite the debate on the role of mortgage loans in the renovation of residential and non-residential immovables.

5 Foreign Currency Loans

The Commission's report concluded that the rules in Art. 23 MCD were effective in preventing consumer exposure to exchange rate risk and default, but it also stated that as a result of those provisions in many countries lenders have stopped offering such loans and in others, there has been a significant reduction of foreign currency loans. In different forums there is a feeling that the MCD 'overshot' in this respect. Foreign currency loans may be a very reasonable solution in places where it is usual to receive one's income in a currency other than the euro (markedly, this occurs with the bordering areas between Ireland and Northern Ireland, and in territories close to Switzerland) or when acquiring a holiday home (or a primary home where to retire) in a foreign country (for example, when a U.S. citizen whose salary is paid in dollars wishes to buy a property in Tuscany). As a result of the MCD, it is quite unlikely that credit institutions will want to undertake the risk of a currency conversion later on at the consumer's request, and thus they do not offer this option or only with stricter requirements.

However, for Member States where a relevant percentage of the total mortgage loans were foreign currency loans,[34] such as Hungary, Greece, Poland or Romania, the MCD's lack of retrospective effect means that consumers with credit agreements concluded before the MCD came into effect are left unprotected, and resourcing to the UCTD proves to be a difficult path, due to domestic courts' reluctance to deem the exchange term contrary to EU legislation. The chapters in this volume concerning the

[32] Focusing on Spain and Portugal, UCI, 'Green Mortgages', November 2018; EEMI/E·On/Basis, 'Appendix: Consumer Research Insights across European Markets on Green Mortgage Propositions', February 2022.

[33] European Commission, 'A Renovation Wave for Europe' (2020) 21-22.

[34] See the chapter on Poland in this volume for an explanation of the difference between mortgages denominated in a foreign currency and mortgages indexed or valorised to a foreign currency, where Habdas points out that the discussion on the adequate classification of the loan detracts from the true issue; i.e. the borrower's exposure to unlimited currency risk, which renders the loan agreement a speculative financial instrument.

four above-mentioned Member States are all critical of the lack of retrospective effect and of the slowness to react in the face of a widespread problem by domestic operators.

It is certainly a matter of policy whether to maintain the current provisions in Art. 23 MCD or to retract from them. Perhaps the danger of consumers being trapped in high-risk investment products such as these are, as stated by Habdas in the chapter on Poland, outweighs the benefits that their reintroduction in European mortgage markets might have for certain consumers, under certain circumstances.

6 Early Repayment, Consumer Mobility (and Avoiding Over-Indebtedness), or the Virtues of the Napoleonic Code in the 21st Century

The MCD (Art. 25) grants consumers the right to early repayment, although Member States may set conditions such as time limitations or compensation for the financial loss experienced by the lender, and they may grant the right only subject to legitimate interest for periods where the interest rate is fixed. The right to early repayment is linked to consumer mobility, which of course fosters competition.

A study commissioned in 2019 showed that few consumers switch provider, despite the savings this could represent.[35] This may be explained by behavioural reasons, lack of awareness or the need to spend time deciding what product to switch for.

The chapters in this volume on The Netherlands and Ireland, for instance, show how frequent claims are concerning early repayment and, especially, the calculation of the lender's financial loss. In Italy, the debate as to whether mortgage credit and consumer credit should be distinguished in this respect, as well as the discussion on the separation between up-front costs and recurring costs has required the intervention, not only of the Italian legislature, but also of the ECJ. The wording of Art. 25 MCD is probably too vague. Moreover, Art. 25 does not apply retrospectively, thus leaving consumers with mortgage credit agreements concluded before its implementation without the right to early repayment. Perhaps, given the duration of mortgage loans (which very often fall within the concept of 'life-time contracts') a case for retrospective application of provisions like these could be made. Although most Member States have adopted precise definitions as to what compensation should be paid, perhaps levelling the playing field within that Member State, differences throughout the EU appear to be significant. This is one of the many reasons why the MCD has not managed to promote cross-border mortgage transactions.

The above-mentioned 2019 study found that only Italy and Spain had clear cut legislation in place to allow switching, while Ireland, France, Portugal and Denmark

[35] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & O. Andruszkiewicz *et al.*, 'Study on switching of financial services and products – Final report' (Luxembourg, Publications Office of the European Union), 2019.

had only a few provisions in force to facilitate it.[36] The same study clearly stated that it did not take into account the administrative and other associated costs that early repayment might entail when calculating the estimated savings that consumers had failed to benefit from by switching, although it then did look into them as potential barriers to changing creditor. Some of these costs are linked to documentation prerequisites for the switch (for instance, where a public deed is needed), others are related to the way in which the switch may take place (for example, when it is necessary to cancel the existing mortgage and create a new one) and others are simply down to concrete legislation (as occurs in Belgium, where the costs of cancelling the mortgage have to be borne by the consumer if the amount due is repaid early, whilst the mortgage would be cancelled by operation of the law, at no cost, by the mere passage of 30 years). This is not an insignificant aspect, and it may explain, to an extent, the problems faced by the so-called 'mortgage prisoners', as described in the chapters on Ireland and on the new consumer duty in the United Kingdom. Indeed, the conditions attached to early repayment are relevant so that the consumer can save money while retaining or terminating the relationship with the original lender, but also so that the borrower is in a position to benefit from better conditions offered at a given time by other potential creditors.

The 'mortgage prisoners' scandal' in the UK and in Ireland appears to have originated in the assignment of mortgage credits to investment (vulture) funds, which have no inclination (or incentive) to renegotiate the terms of the agreement to the consumer's benefit. Moreover, given that in those two systems mortgage loans are typically entered into for a fixed interest rate during a given period of time, after which the lender's interest rate will apply unless an agreement to remortgage is reached, with all the costs this entails, the current wording of Art. 25(5) MCD would allow Member States to subject the right to early repayment to a legitimate interest during the fixed-rate periods.

This scenario is not new. The 1804 French Civil Code included a provision, according to which: 'Lorsque le débiteur emprunte une somme à l'effet de payer sa dette, et de subroger le prêteur dans les droits du créancier. Il faut, pour que cette subrogation soit valable, que l'acte d'emprunt et la quittance soient passés devant notaires ; que dans l'acte d'emprunt il soit déclaré que la somme a été empruntée pour faire le paiement, et que dans la quittance il soit déclaré que le paiement a été fait des deniers fournis à cet effet par le nouveau créancier. Cette subrogation s'opère sans le concours de la volonté du créancier' (Art. 1250(2)).[37] Its origins can be found in an edict issued by

[36] See Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & O. Andruszkiewicz *et al.* (2019) 57 ff. and annex 3.

[37] See now, however, Art. 1346-2 French CC, introduced by Ordonnance no. 2016-131, 10 February 2016. The elimination of the change of creditor at the debtor's initiative may respond to the fact that the list of cases where payment of someone else's debt allows the new creditor to enter into the position held by the original creditor was replaced by a more general clause (Art. 1346 French CC). However,

the king in 1609 at a stage when interest rates were falling. The purpose of the edict was precisely to enable borrowers to repay the loan early, with funds borrowed from another creditor, who would then be granted the same position as the original creditor, in terms of preference and securities attached to the loan.[38] In a similar context at the beginning of the 90s of the last century in Spain, the origins of Art. 1211 of the Spanish CC were traced back to the Napoleonic rule and, as a result of an article published in one of the main Spanish newspapers,[39] the idea of applying Art. 1211 of the Spanish CC to mortgagors was adopted by the Ministry of Economy. This led to the promulgation of Law 2/1994, 30 March, whereby the mechanism already provided for in the Civil Code was regulated in more detail, granting the original creditor the right to match the new creditor's offer in order to retain the client, and limiting the fees, taxes and other costs involved in the early repayment of the loan, which of course does not entail its termination, but a change of creditor (or a modification of the terms of the loan if the creditor remains the same), who will retain the same position, also with regard to the collateral, as the original lender. These provisions have been amended a number of times, always with the aim of reducing the costs associated with the change. The latest amendment to date no longer restricts its scope to financial institutions (i.e. the change of creditor is possible whenever the definition of creditor as per the MCD is met) and it allows the borrower to switch creditor even if the original lender offers the same conditions as the new one. After all, it is a question of costs, but also of trust.

The fact that the immediate precedent of the Spanish law can be found in the 1804 French Civil Code would suggest that, for a number of Member States, the need to facilitate a change of creditor without terminating the existing mortgage credit and entering into a new one, with all the costs this entails and with the new creditor possibly losing its privileged position, has been felt for at least two centuries. In other systems, such as the Czech, consumer protection has been taken further by balancing the interests of creditors and borrowers, but probably leaning in favour of the latter, as it allows early repayment of up to 25% of the principal every year free of charge, among other provisions. In Belgium, the consumer may repay early in full or up to 10% of the outstanding loan per year free of charge. In most systems, however, the problems generated by the unclear definition of 'financial loss' appear to be generating an inordinate amount of litigation. This panorama would probably justify a harmonised provision in the revised MCD, not only when certain credit institutions are involved, but whenever the owner of the mortgage credit (whether the original creditor or an assignee) acts in the course of its trade or business. Clarification is a

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it should be noted that, prior to the reform, there was discussion as to whether the debtor could impose acceptance of payment (by a new creditor) prior to maturity; see: Stoffel-Munck (2015) 56.

[38] Hernández-Moreno & Viola Demestre (1996) 397 ff.

[39] Hernández-Moreno & Méndez González, 'Coste del cambio de hipoteca', *La Vanguardia* 3 October 1993.

must. Going even further and considering adopting a rule of no compensation should not be discarded upfront. An effective right to switch could also help consumers facing difficulties insofar as these derive from unfair contract terms that increase the amount due, such as interest rate floor terms or biased indexes in tracker mortgages, as it may be quicker to change creditor than to obtain a judicial decision on the unfairness of a term of the contract. However, if the repayment difficulties are due to the consumer's circumstances only, borrowing from another lender will probably not be possible, given the need to pass the creditworthiness assessment.[40]

7 Enforcement and Forbearance

The problems surrounding mortgage enforcement are manifold and closely connected to each Member State's particular contractual, procedural and property law systems, including land registration, all of which are areas that the EU will not (and often cannot) legislate on. The following subsections of this chapter explore the aspects covered by the MCD and the very welcome trend, now also at EU level, to view enforcement as the last resort remedy when a consumer is undergoing difficulties, especially when the primary home is at stake.

7.1 Alternatives to Judicial Enforcement

The MCD does not interfere with domestic laws on enforcement. As well as the obligation that reasonable forbearance measures are in place prior to enforcement (see below subsection 7.2), it is mainly concerned with: (a) the penalties in the event of default (Art. 28(2) and (3)), which will not be dealt with here;[41] (b) ensuring that Member States do not prevent the parties to a credit agreement from expressly agreeing that return or transfer to the creditor of the security or proceeds from the sale of the security is sufficient to repay the credit (Art. 28(4)), and that (c) Member States have procedures or measures in place so that the best-efforts price for the collateral is obtained, when said price affects the amount owed by the consumer, and to facilitate repayment if there is still an outstanding debt after enforcement (Art. 28(5)). Art. 28 can be read in conjunction with Arts 19 (for the underwriting process) and 26 (focused on financial stability rather than on consumer protection).

Art. 28(4) MCD has been understood to amount to a tacit abolition of the prohibition of *lex commissoria* in Greece. In Spain, where the prohibition also exists (Art. 1859 of the Civil Code), the MCD provision has not even been copied into domestic law. There are studies considering the admissibility of the so-called *pactum Marcianus* for different reasons, including on the grounds of the mandate contained in Art. 28(4)

[40] In the same vein, see Nield & Jordan in Chapter 5.

[41] See Arroyo Amayuelas (2021).

MCD,[42] often inspired by the Italian experience, where it is accepted, despite the prohibition of *lex commissoria* in Art. 2744 of the Civil Code. In France, Arts 2451 to 2453 of the Civil Code allow the agreement whereby the creditor may appropriate the collateral upon default, subject to objective appraisal and potential return of the value exceeding the outstanding loan to the borrower (or to other creditors), insofar as the mortgaged property is not the debtor's primary residence. It is curious to observe how common law systems have moved away from strict foreclosure and prefer granting the creditor an order of sale, precisely to prevent the lender from gaining an excessive or disproportionate advantage due to the value of the collateral exceeding the amount due, whilst jurisdictions where the lender has been traditionally barred from appropriating the collateral in the event of the borrower's default, seem to be exploring ways to deviate from said prohibition, and, in particular, are willing to accept that the parties may agree from the outset that, in case of default, the creditor will be allowed to sell the encumbered property in order to obtain the amounts due, under certain conditions aimed at guaranteeing a fair price and a just distribution thereof. Undoubtedly this is sometimes a reaction against very long judicial enforcement proceedings, as is the case in Italy. In some systems, such as the Lithuanian, transfer of ownership as security is expressly accepted.

However, it is important to highlight that Art. 28(4) MCD need not be considered a tacit abolition of the prohibition of *lex commissoria*, and it certainly should not be deemed to justify the appropriation of the security or of the price obtained by transferring it by the lender when these values disproportionally exceed what the debtor owes. This is left to domestic law. Art. 28(4) MCD simply provides that the parties should not be precluded from agreeing that the transfer of the security or the proceeds of its sale to the creditor may suffice to discharge the debtor. It does not by itself impose a new form of 'strict foreclosure' in the common law sense of the expression. Therefore, systems where the *pactum Marcianus* is subject to certain conditions, as well as those where parties may agree *ab initio* that the mortgage loan is non-recourse or, at the time of default, may agree on transferring the mortgaged property to the lender in lieu of payment, should be deemed to comply with the MCD. Other interpretations would constitute a step backwards in the protection of consumers, and borrowers in general. A European Union law allowing or even forcing consumers to surrender their property right to the creditor in the event of default could lead to scenarios of disproportionate enrichment for the lender. Although in a rising market it is logical to sell in order to avoid mortgage enforcement, there can be many reasons why this is not possible for the borrower in a given case and/or in the space of time in hand. Moreover, in full-recourse systems, it would mean that the creditor takes advantage of, but does not suffer from, property market fluctuations. Although poorly expressed, this is confirmed by Art. 28(5) MCD, when it demands that measures are in place to guarantee that the best-efforts price is obtained when

[42] Díaz Gómez (2019).

the price affects the amount due by the consumer. Therefore, it is possible that the price obtained determines whether the debtor is discharged and to what extent, and also whether there are amounts due to the owner of the mortgaged property if its value exceeds the outstanding debt.

As for the second paragraph of Art. 25(5) MCD, only the Spanish report states that some measures were adopted, before the MCD was transposed, in order to alleviate the borrowers' position when their primary home has been enforced upon and there is still outstanding debt, although their effectiveness is more than dubious. Other mechanisms, such as fresh starts in the event of insolvency, are not discussed throughout this book.

Most systems represented in this volume require judicial intervention for the lender to enforce the mortgage upon default. There are exceptions in Spain, where a notarial auction is possible if so agreed when concluding the mortgage agreement, but this alternative becomes judicialised if the debtor opposes enforcement, for instance, on the grounds of the mortgage loan containing unfair terms. A relevant exception to the general trend can be found in The Netherlands, where notarial, out-of-court auction, appears to be the default enforcement system. This, as will be discussed in the following subsection, means that it is difficult to assess whether enforcement is actually the last resource, after forbearance measures have failed or were unviable.

7.2 Forbearance Prior to Enforcement

One of the aspects to be analysed during the review of the MCD is whether it should go further in preventing over-indebtedness and granting sufficient protection to consumers undergoing financial difficulties.[43] However, the 2021 NPLD, as well as introducing enhanced consumer protection in the event of credit assignment,[44] amended Art. 28 MCD.[45] Member States should have transposed by 29 December 2023, but many have not and, even those that have, may not have included the amendments to Art. 28 MCD.

In its original wording, Art. 28(1) MCD was so vague that many domestic legislators found transposition unnecessary. No specific obligations appeared to derive from it. On the surface, it may seem that the NPLD has not introduced significant changes.

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[43] This subscection summarises the ideas to be published in a forthcoming book edited by Irene Visser (*Procedures of forbearance and mortgage enforcement. A comparative overview of systems in Europe, the USA and South Africa*, The Hague: Eleven International Publishing).

[44] See new Articles 27a and 28a MCD.

[45] In a similar vein, the NPLD introduced Art. 16a in the Consumer Credit Directive; see now Art. 35 CCD 2023.

However, some differences can be found and, if generously construed, these changes may grant the provision added substance.

First, a change in the language used can be detected: it is more straightforward. It is no longer enough for Member States to 'encourage' creditors to adopt reasonable forbearance measures. Now they shall 'require' creditors to have in place adequate policies and procedures to that effect, although this only applies 'where appropriate' (namely when a solution is viable).

Second, the new Art. 28(1) MCD has the advantage of clarifying one of the aspects that must be considered when exercising reasonable forbearance: the consumer's circumstances. It could be held that objective or standardised classifications of consumers would suffice to determine whether they may benefit from forbearance measures. A broader interpretation, however, is also possible and probably more adequate from a consumer protection point of view. Recital 56 NPLD gives some clues in this direction: the circumstances to be taken into account are *individual* circumstances. Now Art. 35 CCD 2023 expressly mentions individual circumstances. Recital 56 NPLD also refers to the consumer's interests, which leads towards a subjective interpretation as well. If this is correct, the creditor must engage with the individual debtor,[46] in order to design a tailored solution aimed at avoiding enforcement.

Third, Recital 56 NPLD leaves no doubt that forbearance measures must consist of certain concessions to the consumer. Thus, the creditor's interest in a concrete credit agreement is qualified by the need to offer a reasonable solution to the consumer, which should in turn translate into increased chances of debt recovery, cost savings and enhanced financial stability.

Finally, and again according to Recital 56 and not directly provided for by the new Art. 28(1) MCD, Member States should have appropriate forbearance measures in place at national level. This can be understood to suggest that the burden of reasonable forbearance cannot lie exclusively on the creditor, and that public aid should be in place for consumers undergoing financial difficulties, especially when tenure of their primary residence is compromised. The EU Parliament was willing to take a relevant step toward protecting the consumer's primary dwelling by preventing assignment of NPLs concerning the debtor's home. This initiative was not adopted, although Recital 56 still refers to homes. The EU Parliament's suggestions to include a list of measures

[46] See the EBA, 'Guidelines on arrears and foreclosure' (EBA/GL/2015/12) 1 June 2015. Because a relevant part thereof has been incorporated to Level 1 EU legislation by means of the NPLD, they have now been amended by the EBA, Final Report on Guidelines amending Guidelines EBA/GL/2015/12 on arrears and foreclosure (EBA/GL/2024/10) 28 June 2024.

that could be considered to amount to reasonable forbearance are the embryo of the approved text.[47]

As for the specific measures that shall be required, it turns out that, of course, there are no new miraculous solutions and that perhaps only one, or more than one (Art. 28.1a MCD) or a 'reasonable number' of them (recital 56 NPLD) need to be in place. Furthermore, as was already the case with the EBA and ECB guidelines,[48] it is possible that different Member States adapt the measures included in the new Art. 28(1) MCD to their own understanding. For instance, 'changing the type of credit agreement' may mean converting it into an interest-only loan or converting a regular loan into a revolving mortgage credit or even changing from a fixed interest rate to a tracker mortgage; 'partial repayments', an expression that refers to early repayment of the principal in the guidelines, may here also include instances where the instalment schedule is modified, perhaps together with other measures (such as an extension of the term).

In light of the preceding considerations, and bearing in mind that the NPLD is inspired by the already-mentioned guidelines, it seems safe to conclude that 'reasonable forbearance' entails the analysis by the creditor of an array of measures that may facilitate the borrower's recovery by restructuring the credit agreement, but this will only be possible if it is expected that consumers will be in a position to meet their obligations, including those that have given rise to refinancing or restructuring the agreement. It is therefore a question of salvaging the agreement, but the concessions to the debtor cannot be identified with a substantial waiver of the debt. The protection of consumers undergoing financial difficulties clashes with the need to ensure responsible lending and, ultimately, the stability of the financial system.

Even under these premises, though, it is relevant to note that the idea of enforcement as the subsidiary response, the last resort, when concessions prove to be unfeasible or when the debtor does not cooperate, is gaining strength. What was hitherto reserved to prudential provisions at the EU level, is now included in the text of the MCD.

Moreover, domestic measures designed to protect certain debtors (e.g. vulnerable debtors whose primary residence is at risk), perhaps against certain creditors only, which may include mandatory intermediation, stays on evictions or discharge in exchange for the transfer of the mortgaged immovable (such as those in force in Spain,

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47 European Parliament (2021), 'Report on the proposal for a directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral', 14 January 2021 (A9-0003/2021).

48 As well as those already cited, see the ECB, 'Guidance to banks on non-performing loans' March 2017 and the EBA 'Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06)' 31 October 2018.

for instance), should not be deemed sufficient to comply with Art. 28(1) MCD, given that its provisions apply to all consumers and credit agreements that fall within its scope.[49]

The Commission's report on the review of the MCD concluded that, given the short period of application of the MCD and its late transposition, there was insufficient data available to adequately assess with a high degree of certainty whether the provisions in Art. 28 MCD had been effective in reducing the risk of foreclosure. Moreover, it envisaged a wider report on private over-indebtedness, in light of the economic impact of the pandemic.

The Commission's call for evidence, launched in November 2021, included as one of the problems that the review aimed to tackle the 'possible need to strengthen the support of consumers at risk of default or becoming over-indebted (because of individual circumstances or systemic economic disruptions such as Covid-19)'. This approach has the advantage of not distinguishing between individual and systemic crises: for consumers, supervening disability or job loss can be as catastrophic as a war or a pandemic, in terms of the capacity to meet their obligations. However, the options considered by the Commission are not very far-reaching at all. The Call only mentioned the possibility of providing debt advisory services and the need to minimise the risk of banking distress and its impact on financial stability. These are the only new aspects included in the CCD 2023.

Although there are significant differences between both Directives (for instance, with regard to the level of harmonisation), the path marked by the CCD 2023 is probably indicative of what may be expected in this respect when (and if) there is a new MCD. The NPLD created a parallelism between Art. 28 MCD and Art. 16a CCD 2008. Art. 35 CCD 2023 now provides for reasonable forbearance: the consumer's individual circumstances have to be considered, as already mentioned, but creditors need not offer reasonable forbearance reiteratively, except in justified cases. Therefore, it would appear that an iteration of failures to meet the obligations deriving from the credit agreement opens the door to enforcement procedures. However, according to Recital 80 CCD 2023, the aim of the provision is merely to exempt the creditor from insisting when the debtor has not responded to an offer within reasonable time; therefore, it could be read to refer to non-cooperative borrowers only. The wording of Art. 35 CCD 2023 has also been altered so that refinancing is optional, but the modification of the original agreement appears to be mandatory, although then not all of the possible measures need to be in place (Art. 35 (2)). There are no changes in the list of measures introduced by the NPLD.

Art. 36 CCD 2023 provides for debt advisory services, which are presented in Recital 81. They must be independent, easily accessible, and entail only limited costs for the

[49] Anderson (2024)

consumer. The advisory services must be specialised, and may include legal counselling, money and debt management and social and psychological assistance. The aim 'is to help consumers facing financial difficulties and guide them to repay, as far as possible, their outstanding debts, while maintaining a decent level of life and preserving their dignity'. It should be noted that this may be rather difficult to adapt to the MCD, especially if the consumer's home is at risk. Instead, the mandate included in the CCD 2023, whereby creditors are required to play an active role in early detection of likely over-indebtedness and refer consumers to debt advisory services, could be adopted by the revised MCD.

Probably not much more will result from the review of the MCD. The fact that mortgage credit agreements often expand over a longer lapse of time than loans covered by the CCD 2023, that the risk of over-indebtedness is higher in bigger loans and that mortgage credit is commonly used to finance the acquisition of essentials (i.e. primary homes) could justify a different approach. Be that as it may, at least considering enforcement to be the last resort is now permeating EU law, and this is an area where the interests of both borrowers and lenders are aligned.

Forbearance measures and their effectiveness differ among Member States. Whilst some foresee specific regulations when the primary home is involved and vis-à-vis vulnerable debtors (Spain), others distinguish between voluntary forbearance and court-imposed forbearance, with the former being severely restricted by prudential regulation, and the latter probably leaving the consumer in a vulnerable position; moreover, the scope and effectiveness of mandatory conciliation are a matter of debate (Belgium). The Romanian experience, with forbearance measures well developed on paper, but rarely applied, stands out. For a completely different reason, the Irish structured approach to forbearance, which occurs both out-of-court and within the judicial enforcement proceedings, is perhaps a model to follow. Precisely as a result of the modifications introduced by the NPLD to the MCD, Greece now requires lenders to adopt appropriate dispute settlement policies that take into account the consumer's personal circumstances prior to enforcement. The fact that in Greece it is a matter of discussion whether the lack of reasonable forbearance by the lender could be used as a defence within the enforcement procedures and that there are concerns as to how to quantify compensation for damages arising from the lack of reasonable forbearance are both indicators of a relevant shift in perception: Art. 28(1) MCD may be, slowly, becoming an effective rule, and not just a programmatic norm. Consumer protection should not be limited to the underwriting stage of mortgage loans. It should continue to safeguard the vulnerable party's position for the duration of the relationship, which can be very long and gravitate around the debtor's primary home.

III Other Matters: Interest-Only Mortgages as Risky Products

Foreign currency mortgages are risky products, as already stated. They are in the Commission's radar, and it remains to be seen what policy option it will adopt.

However, there are other risky mortgage agreements that do not seem to be specifically considered at this stage of the review of the MCD. This is the case of interest-only mortgages, i.e. those where the principal (or a significant part thereof) is not repaid by means of periodical instalments during the mortgage term; instead, it is to be repaid at the end of the term of the mortgage.

The attraction of these mortgage credit agreements for consumers lies in the lower monthly repayments. For lenders, the principal yields interest for the duration of the mortgage agreement, because the borrower continues to owe the total amount of the loan, unlike what occurs when the monthly instalments comprise both interest and gradual repayment of the principal. The lender risks not receiving the principal when it is finally due (no matter how thorough the creditworthiness assessment is, it is not infallible, and it cannot predict what the consumer's situation will be in twenty- or thirty-years' time). This, by itself, renders such products risky for both parties. Moreover, they are usually sold together with other products, so that the amount that the borrower would typically be paying as principal included in the monthly instalments, is otherwise invested. For this to be appealing to the consumer, the investment ought to be expected to yield more than what will be due when the principal needs to be repaid. Often, the lender or another entity that is part of the lender's group manages the investment product. Therefore, instead of placing one product only (the mortgage credit), the lender (or its group) places two (the mortgage credit and the investment product). Being separate products, if the investment fails to perform as expected, the consumer alone is burdened with the risk of not being able to meet the obligation to repay the principal of the loan. As explained by Nield & Jordan in this volume, it was provided provided that affordability should be thoroughly assessed and that a credible repayment strategy should be in place without relying solely on the sale of the mortgaged property. This, of course, does not dispel the risk of the investment falling short of yielding an amount that suffices to repay the principal when it becomes due. It appears that in Member States where interest-only mortgages are or have been popular, including and Ireland and the Netherlands, this type of mortgage loan is problematic. As noted by Nield & Jordan with regard to the United Kingdom, the fact that a standard forbearance measure is to switch to a period of interest-only repayments does not help borrowers perceive the risks involved. Such risks would justify more stringent harmonised rules at EU level.

IV Final Thoughts

The preceding pages have sought to highlight some (by no means all) of the many problems that continue to populate the arena of mortgage credit. The persistence of known issues and the emergence of new products and actors leading to new challenges are understandable given that, on the one hand, mortgage loans are, in many cases, the means to finance the biggest investment in a consumer's life (i.e. buying a home), and on the other hand, this also entails that a relevant share of the mortgage financial industry's market relies on consumer credit. Moreover, the duration of mortgage loans is such that changes in the economic, social, technological, and even environmental contexts are bound to have an impact on pre-existing contracts and securities. Hence why, for some of the areas discussed in this introductory chapter and throughout this volume, retrospective effect of EU-level harmonisation should not be discarded without careful consideration.

In this book, different perspectives and evolutions of domestic markets and regulatory frameworks can be found, but perhaps two aspects permeate a number of chapters and are worth pointing out here.

The dispersion of rules governing mortgage credit appears to have been an ailment common to many jurisdictions. The MCD has had an impact in this area forcing a certain degree of aggregation, which renders the system more manageable for all those involved. Portugal is an example of this. But in other Member States, normative dispersion continues to pose problems, and this is often found to lead to low effectiveness of the measures in place, sometimes because of lack of consistency between supervisory and judicial decisions, perhaps explained by the courts' reluctance to move away from liberal conceptions of contracts among equals. Romania is an outstanding example in this respect, together with Poland, but also the Netherlands, when it comes to difficulties to apply the UCTD to mortgage credit. Moreover, there will always be a certain degree of normative dispersion surrounding mortgage credit, given that the body of rules governing the financial system follows its own agenda. An example of this can be found in the NPLD: while endeavouring to not curtail consumer protection, it has a completely different goal, related to financial stability. Thus, this kind of regulation is not designed to, and probably never will, solve problems arising in some jurisdictions from mortgage credit assignment, whether performing or non- performing, to both EU- and non-EU companies (see the case of Romania, as well as the considerations made in the chapter dedicated to Greece). And there are still other aspects to be dealt with, such as the 'silent assignments' to unspecified individuals by means of online platforms, as described in the chapter on Lithuania, or the fact that perhaps credit intermediaries, as well as brokers, should be subject to stricter regulations, as stated in the chapter on Poland and discussed from the Czech perspective as well. The different focus of various pieces of EU legislation mirrors the fact that immovables (including homes) are both consumer goods and investments.

The second aspect that appears in different chapters of this volume and that is worthy of attention is that consumers, regardless of the letter of the law and how strict this may be, experience problems when it comes to remedy a situation created by lenders' bad practices, or even by straightforward infringements of the law. The absence of effective means of enforcement of consumer protection rules, the costs, time and stress involved in litigation, for modest or large amounts, is a pressing problem in most jurisdictions. In some, the supervisor or other bodies may be slowly acquiring awareness of the need to address mortgage loan problems suffered by consumers, but they are not always backed by the courts, or these may not be accessible from a realistic point of view. This suggests that out-of-court solutions are required, and that perhaps, as well as access to financial advice, consumers need to have the possibility of obtaining agile and mandatory responses prior to embarking on an uncertain journey within the judicial system. It would be important to ensure that, if the issue needs to be resolved by the courts, the initiative corresponds to the lender, instead of leaving it to the weak party, who lacks the means, the knowledge and the energy to sue a big corporation.

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CHAPTER 2

ARTIFICIAL INTELLIGENCE AND CONSUMER PROTECTION IN CREDIT AGREEMENTS

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I Introduction

Directive 2014/17 of 4 February 2014 on consumer credit agreements for residential immovable property (MCD) needs to be revised in compliance with Art. 44 to continue to ensure an efficient and competitive internal market with a high and equivalent level of consumer protection.[1] Some of these reforms require taking into account new players and techniques in the credit granting process.[2] FinTech companies base their business on artificial intelligence,[3] but the digitalisation of financial services also affects traditional banking, even if it is still a long way from

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[1] See Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission), Risk & Policy Analysts (RPA), 'Report on the Evaluation of the Mortgage Credit Directive' (Luxembourg, Publications Office of the European Union), November 2020. Available at: https://data.europa.eu/doi/10.2874/41965https://op.europa.eu/en/publication-detail/-/publication/e4a1db26-2f94-11eb-b27b-01aa75ed71a1. There is another document still in progress and not publicly available prepared by ICF ('Study on impacts of a possible revision of the Mortgage Credit Directive. Interim Report', October 2022).

[2] See Organisation for Economic Cooperation and Development (OECD) (2021).

[3] For the definition, see Art. 3.1 of Regulation (EU) 2024/1689 of the European Parliament and of the Council of 13 June 2024 laying down harmonised rules on artificial intelligence (AI Act) (OJ 12 July 2024), according to which artificial intelligence is a machine-based system that is designed to operate with varying levels of autonomy and can exhibit post-deployment adaptability and which, for explicit or implicit goals, infers from the input information it receives how to generate output results, such as predictions, content, recommendations and decisions, which can influence physical and virtual environments.

completely replacing humans with digital assistants. In any event, part of the housing credit process is already digitalised, if not fully automated, particularly in terms of online advertising and information, due to credit scoring companies that profile consumers and assess their creditworthiness.[4] The use of artificial intelligence presents challenges that legislators will have to consider when reforming the MCD. To begin with, the entry into the market of price comparison platforms raises the question of whether they fall within the definition of credit intermediary provided in Art. 4(5) MCD. Moreover, the fact that these platforms are used to compare offers from different lenders illustrates the obsolescence of a system which is no longer either convenient or practical and consists of compiling European Standardised Information Sheets (ESIS) on paper or digital mediums so that offers can be compared.[5] On a further point, it is important to note that lenders are increasingly using artificial intelligence to assess consumer creditworthiness, which requires special care so that consumers' fundamental rights are not infringed and, furthermore, to prevent the use of non-conventional data sources from resulting in the exclusion of certain individuals or groups from credit.[6] At this point, the confluence of the Regulation (EU) 2016/679 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data (GDPR)[7] and the AI Act may complicate matters when it is not clear which regulation acts as a special law and one or the other overlaps with the MCD.

The analysis of Directive 2023/2225 of 18 October 2023 on consumer credit agreements (CCD 2023)[8] leads to discussing whether the solutions it provides for some of the controversial issues are the most advisable, and whether, for that matter, it would be wise to improve the regulation in the future MCD.

Loans among individuals and crowdfunding are not yet forms of housing finance. CCD 2023 excludes peer-to-peer lending (crowdfunding credit service) for the time being,[9]

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[4] As set out in Recital 71 GDPR, creditworthiness assessments via automated processing include profiling (Art. 4(4) GDPR). See Article 29 Data Protection Working Party (2018).

[5] Gsell (2022) 138.

[6] Ferretti (2018); Aggarwal (2021).

[7] OJ L of 4 May 2016.

[8] OJ L of 30 October 2023

[9] They were excluded on the initiative of the Council of the European Union. Doc. 9433/1/22 REV 1. Brussels, 7 June 2022, III. 10 a): '[…] delegations expressed concerns about the inclusion of direct crowdfunding credit services between private individuals in an act relating to consumer protection (which covers B2C relations). The Presidency proposes that this type of credit be taken into account in a separate act and therefore deletes all references to it. As a reminder, crowdfunding credit platforms

and the Crowdfunding Regulation does not cover consumer credit agreements either.[10] For all these reasons, it is sensible to expect that they should be governed under a separate regulation, and in any event, one that is different from the reform of MCD,[11] and so this issue will not be dealt with here.

II Credit Intermediaries and Comparison Platforms

Under Art. 4(5) MCD, credit intermediaries do not act as lenders, nor are they notaries, nor do they simply bring consumers directly or indirectly into contact with lenders or credit intermediaries.[12] Acting as intermediaries entails their intervention in the presentation, the offer, the preparations or the concluding of credit agreements (Art. 4(5)(a)(b) and (c) MCD).

Recital 74 MCD could imply that advertising a particular lender or product is also inherent to the work of intermediaries:

> 'Persons who merely introduce or refer a consumer to a creditor or credit intermediary on an incidental basis in the course of their professional activity, for instance by indicating the existence of a particular creditor or credit intermediary to the consumer or a type of product with this particular creditor or credit intermediary to the consumer without further advertising or engaging in the presentation, offering, preparatory work or conclusion of the credit agreement, should not be regarded as credit intermediaries for the purposes of this Directive.'

However, what counts in the work of intermediaries is finding and negotiating the most advantageous mortgage loans for consumers. It would therefore make sense for qualifying as a credit intermediary to require another activity in addition to merely advertising or providing general information about one or more lenders.[13]

There is currently a proliferation of mortgage comparison platforms, which do not charge borrowers for their services but do levy fees on banks (between 1% and 2% of

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are already covered by the Directive in cases where they act as creditors or as credit intermediaries.' On future plans, see Art. 46(2) CCD 2023.

[10] See Art. 1(2)(a) Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (OJ L 347 of 20 October 2020).

[11] Opinion of the EBA (2022) 4, no. 21.

[12] The definition is identical to that provided for in Art. 3(12) CCD 2023. See Recital 27 CCD 2023. Previously, Art. 3(f) CCD 2008.

[13] De Muynck & Bruloot (2017) 12.

the amount of the loan),[14] but they sometimes intervene in setting the interest rate to be paid by the customer by offering advantages to certain banks.[15] Many fall within the definition of online platforms and search engines in the Digital Services Act[16] (Art. 3(2)(i) and (j) DSA). They constitute examples of intermediary services (Art. 2(2)) that the DSA subjects to different requirements and conditions in providing the service.[17] The fact that intermediaries automatically index the information stored, have a search function and/or recommend information on the basis of the profiles or preferences of the service recipients does not affect their classification as intermediaries in accordance with the DSA definition, and therefore no one would argue that these platforms should not be deemed to provide intermediary services when they inform consumers of the best mortgage offers on the basis of their profiles. Nowadays platforms do not limit themselves to simply matching consumers and lenders and almost all provide search and information functions so that consumers can choose from among a range of offers, which the platforms promote according to lenders' terms and conditions.

However, their functions as intermediaries under the umbrella of the DSA simply consists of directly or indirectly putting consumers in contact with creditors, a notion that does not match the concept of intermediation as described in the first part of Art. 4(5) MCD. In fact, to qualify as intermediaries, platforms are also required to provide or facilitate credit agreements with consumers. In order to qualify as an intermediary under the MCD, it is therefore not sufficient to point out the existence of one or more particular loans or to influence the order of the offers if, moreover, no personalised information is provided or consumers are not permitted to conclude contracts through the platform itself or by other means. Similarly, Art. 2(1) of Directive (EU) 2016/97, of 20 January 2016 on insurance distribution,[18] points out that an insurance intermediary activity includes:

> 'the provision of information concerning one or more insurance contracts in accordance with criteria selected by customers through a website or other media and the compilation of an insurance product ranking list, including price and product comparison, or a discount on the price of an insurance contract, when the customer is able to directly or indirectly conclude an insurance contract using a website or other media'.

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[14] López Herrero & Mariscal de Gante Burguete (2024).

[15] Gsell (2022) 139.

[16] Regulation (EU) 2022/2065 of 19 October 2022 on a Single Market for Digital Services and amending Directive 2000/31/EC (Digital Services Act, DSA) (OJ L 277 of 27 October 2022).

[17] On this issue, Arroyo Amayuelas (2024a).

[18] OJ L 26 of 2 February 2016

Of course, should intermediaries intervene more actively in the mortgage contracting process, which implies that they influence the obtaining of contracts, this would count as the work of an intermediary, as they would therefore be acting more as digital assistants; for example, if intermediaries obtain mortgage loans that present certain difficulties (e.g. for purposes other than the purchase of a primary residence or for a high loan-to-value ratio).[19] However, the extra services provided by many platforms, such as loan repayment simulators and monthly offers listings compiled by experts, do not amount to participating in the submitting, providing, preparing or concluding of credit contracts.

It is therefore necessary to look specifically at each platform's services in order to decide which of them match some or all of the activities described in Art. 4(5) MCD.[20] This is why, despite the fact that credit intermediaries have to be registered (Art. 15(1)(b), Art. 29(4) MCD), not all mortgage comparison platforms are registered as credit intermediaries, a fact which can certainly be justified by the differences in their functions.[21]

The exact classification of comparison platforms, which sometimes also serve as robo-advisors, is a contentious issue in view of what appears to be a range of solutions in the EU, which will require further clarification in a future reform of MCD.[22] It would therefore be useful to specify in the future MCD that platforms that gives discounts, help consumers to fill in applications with a view to entering into contracts that can be concluded through the platform or otherwise, or assess the suitability for consumers of contracts offered via lenders' websites, are deemed to be credit intermediaries.[23] These functions are already partially performed by automated managers and advisors in areas such as investment.[24]

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[19] These examples appear in López Herrero & Mariscal de Gante Burguete (2024) and are used by the authors to show what is generally not done by platforms that merely connect lenders and consumers, but which the authors classify as intermediaries.

[20] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 108.

[21] Cf. HelpMyCash and Hipoo on one hand and Rastreator on the other (in Spain). For an appraisal of credit intermediaries, see https://futurfinances.com/broker/comparador/. For a different perspective in Belgium, see J. Vannerom in the corresponding chapter of this book.

[22] Report from the Commission to the European Parliament and the Council on the review of Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property, Brussels 11.5.2021, COM (2021) 229 final, 10 and 12.

[23] De Muynck & Bruloot (2017) 12; ICF (2022) 53-55.

[24] On this issue, Rodríguez de las Heras Ballell (2019) 1241-1251; Gurrea-Martínez & Wan (2023) 178-197.

III Advertising and Information about Credit

Digitalisation and the growth of artificial intelligence facilitate the use of different communication channels, including smartphones, apps and social media. This requires adopting measures to standardise the presentation of advertising and pre-contractual information on different media and devices, as was done in the reform introduced by the CCD 2023 and Directive (EU) 2023/2673 on distance financial services.[25] Basic information thus needs to be selected and adapted to the chosen medium so that what is considered essential can be viewed effortlessly (e.g. without having to scroll up or down the screen or click on a button). The CCD 2023 rule on advertising thus considers minimum essential information to include details of interest rates and charges, the Annual Percentage Rate of Charge (APRC), the total amount and duration of credit, extendable in the case of credit in the form of deferred payment for goods or services, the cash price and the amount of any advance payments, the total amount due and the amount of regular instalments if the medium used (website pop-ups/banners, social networks) so permits: the fact that these all have specific features (length of message, transmission times, etc.) demands different approaches.[26]

The CCD 2023 continues to rely on standardised pre-contractual information forms to aid understanding and comparing offers; these are now restricted to a maximum of two pages and the way in which the compulsory information should be organised is specified; that is, essential information must appear on the first page and other important details at the top of the two pages.[27] Without abandoning the ESIS format, this layering of information and its adaptation to the mediums has also been suggested in relation to the reform of the MCD.[28] However, the increasingly widespread use of

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[25] On the forms in which the information is presented, see Recitals 30-33 and Art. 16a (7) Directive (EU) 2023/2673, of 22 November 2023, amending Directive 2011/83/EU as regards financial services contracts concluded at a distance and repealing Directive 2002/65/EC (OJ L of 28 November 2023). Banks insist on the need to reduce the essential information provided to consumers and to adapt it to the digital environment. Hence, European Savings and Retail Banking Group (ESBG), 'European Commission public consultation on the Review of the Mortgage Credit Directive', February 2022, 6-7, 16, 19; German Banking Industry Committee, 'Comments Review of the Mortgage Credit Directive by the European Commission - Public consultation and call for evidence', 28 February 2022, 6. Available at : https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13090-Mortgage-credit-review-of-EU-rules/feedback_en?p_id=27490933

[26] Art. 8.3 CCD 2023. Regarding the reform of the MCD, see European Mortgage Federation-European Covered Bond Council (EMF-ECBC) Response to the EC Public Consultation on the Review of Mortgage Credit Directive', 24 February 2022, 23 (own pagination). Available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13090-Mortgage-credit-review-of-EU-rules/feedback_en?p_id=27490933

[27] For an overview, Arroyo Amayuelas (2024b) 8-9, 22; Cherednychenko (2024) 247-248; Artz (2024) 1067.

mortgage comparison platforms not only underlines the need to ensure that consumers who are interested in obtaining credit can be certain that platforms will act neutrally and independently – an issue that is regulated in other legislation[29] - but also, for current purposes, is evidence of the unquestionable fact that all platforms present the information that they wish to highlight in different ways. It would therefore make sense for the European legislator to enable the information currently provided through the ESIS to be made available in digital form and as an alternative to paper or durable mediums to create a standard offer comparison tool for consumers, as provided for in Directive 2014/92/EU on payment accounts.[30] These comparison platforms or websites should cover as many offers as possible, include a significant part of the market and provide reliable, impartial and transparent information (Recital 22). These websites must give their owners' details and clear and objective criteria on which comparisons are based (Art. 7(2) and Recital 23). The independent comparison website model means that information can be standardised and only essential details given, while allowing providers the flexibility to supply further elements of comparison.[31] The objections that have been raised, such as the claim that the information they provide does not necessarily help consumers to understand or weigh up the different factors involved in taking out a mortgage or choosing between fixed and variable rate mortgages are untenable, firstly because they are not specific to the information provided by the platforms, and secondly because legislators can reverse

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[28] EBA (2022) 4, 5 no. 22, 23. In contrast, the International Union of Property Owners (IUPO), 'Comments on the Mortgage Credit - Review of EU Rules Initiative', 3-4, suggests being able to have more confidence in lenders' websites. Available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13090-Mortgage-credit-review-of-EU-rules/feedback_en?p_id=27490933. See also EMF-ECBC (2022) 6, 16 (own pagination).

[29] Online search engines are obliged to disclose the relevant parameters used in rankings and their weighting (Recital 20 and Art. 3(7) of the Omnibus Directive (EU) 2019/2161, amending Annex I Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market and introducing a new Art. 11a). The same transparency is required in B2B contracts by Regulation (EU) 2019/1150, 20 June 2019 (Recital 24-27, Art. 5). In addition, Art. 7(4)(a) Directive 2005/29 and Art. 6a(1)(a) Directive 2011/83/EU on consumer rights, as amended by Arts 3(4)(b) and 4(5) of the Omnibus Directive (EU) 2019/2161. Idem, Art. 27(2)(a) and (b) Regulation (EU) 2022/2065 of 19 October 2022 on a Single Market for Digital Services and amending Directive 2000/31/EC (Digital Services Act). Access gatekeepers also have transparency obligations (Recital 45, 52, 58, 72, Art. 6(8)-(10), 15 DMA) without prejudice to due regard for the protection of trade secrets.

[30] Directive 2014/92/EU of 23 July 2014, on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (OJ L 257 of 28 August 2014). The idea and its development is in Gsell (2022) 137 ff. See Directorate-General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 99: 'In some countries at least, consumers appear to prefer using comparison websites, rather than the ESIS, to compare offers from different lenders and some stakeholders suggested that the ESIS should have greater portability into comparison website processes.' See also, EMF-ECBC (2022) 17.

[31] Gsell (2022) 141-142. See also, Recital 23 and Arts 4 and 7 Directive (EU) 2024/1799 of the European Parliament and of the Council of 13 June 2024 on common rules promoting the repair of goods (OJ L 2024/1799 of 10 July 2024).

this situation by stipulating exactly what information is required and how it is presented.[32]

IV Assessing Creditworthiness Using Automated Data Processing (ADP)

1 Creditworthiness

The provisions on creditworthiness in European credit directives are of the utmost importance because they are the main means of establishing whether consumers qualify for the loan or credit that they apply for and within what limits. The aim is to prevent the irresponsible granting of credit, both in the interests of lenders (avoiding losses in the event of non-payment) and consumers (ensuring affordable credit),[33] although the CCD 2023 underlines the latter (Recital 54 and Art. 18(1) CCD 2023), with the aim of preventing lenders from basing their business on the risk of consumer default (e.g. in the form of high interest rates for those with higher risk profiles).[34] Art. 18 MCD stipulates that lenders must perform thorough assessments of consumers' creditworthiness before concluding credit agreements - and also when significantly increasing the amount or limit of the credit - and for this they must take due account of the factors that make it possible to verify consumers' prospects of meeting their obligations. Art. 20(1) MCD adds that this assessment is to be carried out on the basis of necessary, sufficient and proportionate information on consumers' income and expenditure and other financial and economic circumstances; Art. 20(3) MCD also states that when consumers are required to give information, it must be proportionate and limited to what is necessary to carry out proper creditworthiness assessments.[35] Art. 18 CCD 2023 takes the same approach. Both directives emphasise that only financial and economic data concerning expenditure and income levels can be considered in assessing creditworthiness, although Art. 18(1) CCD 2023 now adds that this must be related to the type of credit, its duration and the amount (cf. Art. 18(6) CCD and Art. 18(5)(a) MCD).

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[32] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 107-108.

[33] Aggarwal (2021) 48.

[34] For the distinction between 'lender-focused' and 'borrower-focused' tests, see Cherednychenko (2024) 252. According to the ECJ 27 March 2014, *LCL Le Crédit Lyonnais SA*, C-565/12, EU:C:2014:190, in Art. 8 DCC 2008, creditworthiness assessments sought to protect consumers. The same point of view is now set down in Art. 18(1) CCD 2023. See Artz (2024) 1067. In the MCD, see Recital 55 and Art. 18(3).

[35] For further analysis, Arroyo Amayuelas (2023); Arroyo Amayuelas (2024c).

2 Structured, Unstructured and Prohibited Data

It is clear that in order to assess creditworthiness it should be possible to consult databases (positive and negative) containing information in the traditional credit sector, but it should also be possible to consult data from different sectors of the economy; that is, non-bank lenders and telecommunications and utility providers.[36] Nonetheless, banks have vast databases on their customers' daily consumption patterns (gas, electricity, telecommunication bills). The proposed Regulation on payment services adopts and extends the regulation of the open banking model, which enables financial institutions to share information on payment accounts with other operators in the system.[37] Admittedly, the Regulation does not extend this data mining to creditworthiness assessment, but the idea can be used to verify information provided by consumers with their consent.[38] The credit directives allow such economic data to be used for this purpose, expressly authorising assessments to take into account consumers' regular outgoings, debts and financial and economic circumstances in general (Recital 55, Art. 20(1) MCD; Art. 18(3) CCD 2023), although none of them specifies the exact data in question.

What CCD 2023 does prohibit (Arts 18(3), 19(5) CCD 2023) is determining creditworthiness by harvesting other types of unstructured data from social networks, which have historically been beyond the reach of computer processing capabilities but which can be used by machine learning: images, video and audio collected from social media, digital footprints left by search engine queries and online browsing activities (post 'likes', clicks and viewing time).

The future MCD should stipulate the type of data recommended for use in creditworthiness assessments, rather than having to supplement the standard with the 29 May 2020 EBA Guide on lending and loan monitoring, which provides guidelines on categories of data that show income or other sources of repayment and further information on financial assets and liabilities or additional financial commitments.[39] A failure to supply these data can be interpreted to indicate that a consumer chooses not to provide the information or verification necessary for an assessment of creditworthiness, which could result in credit being refused (Arts 18(4), 20(4) MCD).

[36] See Mas Badia (2021); also, Perel & Plato-Shinar (2023) 160 ff.

[37] See Chapter 3 of the Proposal for a Regulation on Payment Services in the Internal Market, COM(2023) 367 final, Brussels, 28 June 2023. Currently, see Chapter 2 of Directive (EU) 2015/2366 of 25 November 2015 on payment services (OJ L 337 of 23 December 2015).

[38] On this point, Pascual Huerta (2021) 630-631. On the other hand, warning of the risks of using open banking because it entails loss of consumers' control over their data and increases the asymmetry between consumers and banks, Bednarz & Przhedetsky (2023) 85-86.

[39] See EBA (2020) 71-72. Criticism relating to the CCD 2023 Proposal can be found in EDPS (2021) 7, no. 18.

On the other hand, the credit directives view obtaining such expenses and economic circumstances as a legal duty, which may indicate that consumer consent is not required for processing them (Art. 6(1)(c) GDPR) and that a legitimate interest would be sufficient for processing it (Art. 6(1)(f) GDPR). Given that the GDPR contains no specific regulation or safeguards for credit information systems, it would be helpful if the new MCD stipulated exactly what unstructured data can be used and how they can be accessed, as it is clear that individuals' spending levels and types of consumer spending can affect their privacy. Of course, it is also necessary to establish what other data may not be used, as provided for in CCD 2023, on the understanding that this prohibition should not be limited to data obtained from social networks but should include search engine query data and online browsing activities. Explicitly extending the ban on the use of unstructured data that provides no direct information on consumers' incomes and expenditure levels to marketing activities would also be desirable in order to prevent vulnerable consumers from being offered high-cost products (cf. Art. 13 CCD 2023).[40]

Prohibiting the use of specially protected data to assess applicants' creditworthiness (Recital 55, Arts 18(3), 19(5) CCD 2023) derives directly from Art. 9(1) GDPR. In particular, health data cannot be included in the information considered by the lender. Health could directly affect expected income during the term of the contract, but only this circumstance should be considered (Art. 18(1) CCD 2023; Art. 18(1) MCD) and not the cause affecting health and for which more or less income is received. In any case, consumer or mortgage credit will certainly not be granted unless a corresponding insurance policy is taken out (Art. 12(4) MCD, Art. 14(3) CCD 2023). Art. 14(4) CCD 2023 provides for (limited) measures to prevent very high premiums in insurance contracts in order to provide consumers who have overcome a cancer with equal access to insurance related to credit agreements (see Recital 48).[41]

3 Consumer Rights and Automated Credit Ratings

CCD 2023 includes numerous references to data protection (Recitals 30, 46, 55-57; Art. 13(2), Art. 18(2) and (3), Art. 19(2), (5) and (7)) and this is of crucial importance in view of the widespread use of artificial intelligence systems for assessing creditworthiness, which are given legal status and classified as high-risk systems in the Artificial Intelligence Act (Art. 6.2, Annex III Art. 5(2)(b) AI Act). Even if the final decision ultimately adopted involves human assessment, and therefore may not be based exclusively on the results derived from the use of artificial intelligence, the

[40] Article 29 Data Protection Working Party (2018) 22. This is not the case in Denmark, according to Hohnen, Ulfstjerne & Sosnowski Krabbe (2021) 42, who also point out that 'most banks have even been reluctant to include such data, because they fear adverse customer responses'. Cf. Art. 26.3 DSA.

[41] There is a thorough analysis in Torrelles Torrea (2024). For a succinct comparative law perspective, see Faccioli (2024).

profiling inherent in credit scoring systems is always considered a high-risk activity (Art. 6(3) *in fine*, Annexe III, Art. 5(b) AI Act).
Pursuant to Art. 22(1) GDPR, individuals have the right not to be subject to decisions based solely on automated processing, including profiling, which produces legal effects on them or significantly affects them in a similar way. However, both CCD 2023 (Art. 18(8)) and the AI Act (Art. 86(1)) recognise and allow credit scoring, which enables the exception in Art. 22(2)(b) GDPR to be considered applicable if the decision affecting the data subject is taken exclusively and/or mainly by automated means. Should this be the case, consumers have rights under Art. 15(1)(h) and Art. 22(3) GDPR (to obtain adequate explanations, express their points of view and object to the decision). Both CCD 2023 and the AI Act contain a new feature, which is that the mere use of automated data processing entitles consumers to these rights. In particular, CCD 2023 enables consumers to obtain explanations, review creditworthiness decisions and object to negative decisions without also having to prove the evidence of harm (Art. 18(8)(a)-(c) CCD 2023; cf. Art. 86(1) and (3) AI Act).

With regard to the right to obtain a clear and intelligible explanation of their creditworthiness assessments and the functioning of the automated processing used, as well as to be informed of the logic and risks involved in the algorithm (Art. 18(8)(a) CCD 2023), it is unclear whether, beyond consistency with Arts 13(1)(f), 14(1)(h), 15(1)(h) GDPR,[42] the scope given to consumer rights in the CCD 2023 should be the same as that in the GDPR – in which this scope is not clear anyway. If these provisions are deemed to provide only general explanations, then it is a question of providing functional explanations on a system's logic (types of data, decision tree categories), its purpose or meaning (e.g. performing a credit rating) and its consequences (assessing creditworthiness to determine whether and under what conditions the credit applied for can be given), in which case the information that should be provided is necessarily limited.[43] If, on the other hand, consumers' rights in credit agreements are 'without prejudice' to the GDPR provisions (Recitals 30, 56), then the CCD 2023 can be said to go further than this rule. The latter interpretation should surely prevail, especially if it is considered that Art. 22 GDPR does not provide for consumers' rights to obtain adequate explanations after the fact that enable them to understand how certain automated decisions were reached. Moreover, unlike Art. 15(1)(h) GDPR, Art. 18(8)(a) CCD 2023 requires much more than merely 'meaningful' information about the logic applied by the algorithm.[44] According to this interpretation, considering a scoring company's commercial interests should never result in a refusal to disclose the

[42] Highlighting the concordance, Marín López (2024) 6.

[43] See Wachter, Mittelstadt & Floridi (2017) 78, 82-84; against, Selbst & Powles (2017) 233-242. Noting the deficient transposition of Art. 15(1)(h) GDPR in member states, see Custers & Heijne (2022) 9 ff. especially 13-14, 16.

[44] Spindler (2021) 259. But see Recital 56 CCD 2023.

factors considered in the decision-making process and their respective weight, as much of the literature argues.[45]

In particular, the new MCD should make provision for explaining the logic of algorithms, including the right to know the weighting of the different categories of data used. This precise suggestion was put forward by the European Parliament with regard to the Consumer Credit Directive proposal, although without success.[46] However, other European rules point in this direction by requiring that actual data on the importance of the ranking parameters used is supplied, while also accepting that neither online intermediation service providers nor search engine providers can be required to disclose algorithms.[47] Contrary to the Advocate General's suggestion, the ECJ C- 634/21, *Schufa*, 7 December 2023[48] does not specifically assess this point, but makes it clear that whoever is responsible for the automated decision must put in place the necessary mechanisms to protect data subjects, and this, if interpreted correctly, indicates that it is no longer possible to hide behind the trade secrets of algorithms, much less so in view of the broad rights to human intervention that the CCD 2023 grants vis-à-vis lenders. Advocate General De La Tour has recently underlined that individuals have the right to know how automated decisions are made and considers it necessary to provide a concise, accessible, easy-to-understand, comprehensive and contextualised information of the methods used, the criteria considered and the weighting of the data used.[49] Therefore, the future MCD could provide clarity on this issue by emphasising transparency in automated decision-making processes involving creditworthiness assessment.

If it also turns out that, in accordance with the recent interpretation of Art. 22(1) GDPR by the ECJ C 634/21, *Schufa*, 7 December 2023, the decision to refuse credit

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[45] Suffice it to point out, with regard to the GDPR, Article 29 Data Protection Working Party (2018) 27; Sancho (2020) 153. In the consumer credit context, Rott (2019) 92. In favour of leaving it to the national judge to balance the interests at hand, Opinion of Advocate General De la Tour delivered on 12 September 2023, *Dun & Bradstreet Austria*, C-203/22, ECLI:EU:C:2024:745, paras 94, 96.

[46] I Report on the Proposal for a consumer credit directive. Committee on the Internal Market and Consumer Protection. Rapporteur: Kateřina Konečká, 25.08.2022 (PE696.560v03-00). Amendment 148 (Article 18 – paragraph 6 – point b): '(ii) the categories of data processed as part of the assessment and the weighting of each category in the decision'.

[47] See Recital 27 and Art. 5(5) and (6) Regulation (EU) 2019/1150; Recitals 22-23 of Directive (UE) 2019/2161. Further references in fn. 28.

[48] Opinion of Advocate General Pikamäe delivered on 16 March 2023, ECLI:EU:C:2023:220, para 58. See ECJ *Schufa*, C-634/21, ECLI:EU:C:2023:220, paras. 57-58. For a commentary on the judgment, see Arroyo Amayuelas (2024d).

[49] Opinion of Advocate General De la Tour delivered on 12 September 2023, *Dun & Bradstreet Austria*, C-203/22, ECLI:EU:C:2024:745, paras 62 ff, esp. paras 74, 76, 96.

must be understood to have already been taken when lenders heavily rely on the credit scoring companies' reports, it would be interesting if MCD clarified that lenders must be able to obtain the same information from scoring companies that they (lenders) have the duty to supply to the data subjects (consumers) affected by their decisions.

V Conclusions

Mortgage offer comparison websites are not yet in common use in all member states, but their use is growing.[50] Art. 4(5) MCD does not make it clear whether these platforms, which sometimes also act as robo-advisors, are actually credit intermediaries and subject to the same conditions and obligations established there. The concept of intermediary should be adapted to current digital reality and indicate the parameters that mean that platforms can be understood to act as intermediaries. These could include giving discounts, helping consumers to completing applications with a view to concluding agreements and providing personalised information to assess the suitability of contracts for consumers, for example.

CCD 2023 was based on MCD and did not wish to depart from the consumer protection model based on the broad imposition of duties of information on lenders, despite the well-known limitations.[51] According to Art. 10(2) CCD 2023, pre-agreement information must be on paper or a durable medium, ensuring the comparability of different offers. The definition of durable medium includes paper (Art. 3(11) CCD 2023) and consumers can decide whether they wish to receive information in this form. The provision is respecting the needs of certain vulnerable consumers who are not very familiar with digitalisation, but it is surprising that, despite the trouble taken by legislators to ensure that information is adapted to the digital medium through which it is provided, there is no provision for a standard offer comparison tool, as there is in other European directives.

Digitalisation has ushered in new players, new products and new ways of marketing them, and the development of artificial intelligence and big data has brought about the exploitation of unconventional data in profiling for marketing and creditworthiness assessment purposes. Data protection is consequently part of consumer protection and it is not plausible that MCD should fail to reflect this complementary aspect. However, where consumers' rights vis-à-vis lenders are granted without prejudice to Regulation (EU) 2016/679, the scope of those rights should be clear in the new MCD.

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[50] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission) & RPA (2020) 99.

[51] Cf. Arts 9-10 CCD 2023 and Arts 13-14 MCD.

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CHAPTER 3

EQUITY RELEASE PRODUCTS AND THE SCOPE OF THE MCD

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I Introduction

In this chapter we analyse some cases in which a person's primary residence is used as the economic basis for the legal configuration of mechanisms that will secure two essential interests when this person approaches old age. The first interest is to have a suitable home; the second one is to ensure sufficient income to maintain a standard of living similar to that enjoyed up until then. The final purpose is to argue that such legal structures should be included within the scope of the revised MCD and with the implementation of stronger transparency rules.

A 'suitable home' will normally be the primary home, but this need not necessarily be the case. It may be another property that, by whatever means, entitles that person to have a stable residence for life; this is achieved by virtue of the economic and legal basis of what was the primary residence, which, in one way or another, continues to be the point of reference or support for the new legal situation created.

This is the case when the primary residence is sold to buy another one at a lower cost (the so-called 'downgrading'), so that this person's residential needs are covered and

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there is additional money available for other purposes. A similar situation occurs when, instead of buying a new home, the person decides to rent it, or even when, with the money obtained, the person covers the cost of a care home. It should be noted that in these cases the elder person transfers ownership of what was the primary residence and does not reserve any right that would allow continuing in its possession, such as the right of usufruct.

An imaginative formula that has gained relevance in this area in recent years in the Spanish Autonomous Community of Catalonia is that of maintaining the right of ownership, but transferring possession of the home to a lender by creating a right of antichresis over it, as a guarantee of the restitution of the loan received. The creditor exploits this property by renting it out, and applies the income obtained to the payment of the debt.[1] The owner and debtor thus receives amounts of money that may be used to pay for a retirement home, for instance.[2]

However, in this context, the cases that awake greater interest from a legal point of view are those based on equity release mechanisms, where the senior person maintains a certain legal link with the primary residence, which acts as a basis or security for the receipt of a periodic annuity, usually a life one, and which allows this person, with one formula or another, to continue living in it. This can be legally embodied in different ways, by means of structures that combine institutions focusing fundamentally on the transfer or non-transfer of ownership of the dwelling, on its encumbrance as a security and/or on the constitution of rights *in rem* over it, such as usufruct.

The problem with these structures is that they do not always offer sufficient legal certainty to the target sector of the population, i.e. normally elderly people, probably already retired, in a somewhat vulnerable situation. These products always entail a risk, be it financial or legal. This occurs, for instance, when senior person who, in order to ensure a decent income to supplement a public retirement pension, sells the primary residence in exchange for a certain amount of money and a life annuity, and reserves the right of usufruct for life. The latter guarantees that the vendor will retain possession of the home and the former entails the immediate disposal of the amount of the sale price, which can be used, for example, to rehabilitate and refurbish the home or to improve its accessibility, in anticipation of a hypothetical situation of disability. This situation would deserve special protection. More specifically, the problem is that legal structures such as these do not, or only in scarce cases, fall within the scope of the MCD, so there may be a lack of protection for consumers who make

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[1] Antichresis is a classic security that, modernised and sometimes with different names, is still present in many civil codes, such as the Catalan (Catalan CC, Arts 569-23 to 569-26) or the French one (Arts 2387 to 2392, with the name of 'gage immobilier').

[2] Anderson (2021) *passim*, is fundamental to understand the concrete legal construction of this antichresis.

use of them. Very often, this deficiency transfers to national legislation transposing the Directive, although sometimes consumer protection is provided, in part, by other means, including through previously existing rules.

The following sections focus, first, on the general legal framework of these institutions aimed at providing care for elderly people. Second, they examine some emblematic cases that, with slight differences, can be found in many European legal systems, such as the reverse mortgage and life annuities, either personal or *in rem*. For the sake of clarity, these institutions will be discussed mainly on the basis of Catalan and Spanish law, as representatives of a broad European *ius commune*, with references to other legal systems. Of course, these institutions do not exhaust all the possibilities of equity release aimed at providing additional resources to elderly people,[3] but they are excellent reference models on which to build perfectly operative legal structures. Finally, this chapter concludes by justifying that these legal structures require more effective protection, so that it would be advisable to include them in the scope of a revised MCD, with the implementation of stronger transparency rules, especially a compulsory notarial advice in all kinds of equity release agreements.

II General Legal Framework

The purpose of Directive 2014/17/EU is to establish a common framework in relation to certain aspects of agreements covering credit for consumers secured by a mortgage or otherwise relating to residential immovable property (Art. 1 MCD). More precisely, Art. 3(1) MCD specifies that the Directive shall apply to credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on residential immovable property or secured by a right related to residential immovable property; and credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building.' Subsequently, the same Art. 3(2) MCD details several situations to which the Directive does not apply. As far as the present study is concerned, its section (a) specifies that it shall not apply to equity release credit agreements where the creditor:

> '(i) contributes a lump sum, periodic payments or other forms of credit disbursement in return for a sum deriving from the future sale of a residential immovable property or a right relating to residential immovable property; and (ii) will not seek repayment of the credit until the occurrence of one or more specified life events of the consumer, as defined by Member States, unless the consumer breaches his contractual obligations which allows the creditor to terminate the credit agreement.'

[3] Besides the sale of the bare ownership whilst reserving the right of usufruct that we have referred to before, another possibility is the sale of successive ownership whilst reserving temporary ownership as regulated in the Catalan CC (Arts 547-1 and 547-4.1). This can be useful when the elder person knows that after a certain date a care home will be the best option, and therefore will no longer need what used to be this person's primary residence.

The meaning of this provision, which is unclear in its wording, is clarified by Recital 16 of the Directive, which justifies the exclusion on the following grounds:

> 'This Directive should not apply to […] equity release products or other equivalent specialised products. Such credit agreements have specific characteristics which are beyond the scope of this Directive. An assessment of the consumer's creditworthiness, for example, is irrelevant since the payments are made from the creditor to the consumer rather than the other way round. Such a transaction would require, inter alia, substantially different pre-contractual information. Furthermore, other products, such as home reversions, which have comparable functions to reverse mortgages or lifetime mortgages, do not involve the provision of credit and so would remain outside the scope of this Directive.'

We cannot agree with the exclusion of equity release products from the scope of the MCD, especially after seeing the reasons provided in Recital 16. Going back to the example of the life annuity, it makes no sense to say that it is superfluous to evaluate the consumer's solvency. Of course, a life annuity is not a credit agreement in the sense of Art. 3(1) MCD, but that does not mean that to evaluate the consumer's solvency, i.e., that person's global economic situation, is superfluous. Especially, it would be very useful to evaluate if there is fair contractual balance in the life annuity agreement, or if there is an evident risk, as when the monthly payments received are too low in relation to the value of the property transmitted in exchange. This is a risky agreement, and even more so if the creditor is an elderly and vulnerable person, so that it would be very useful for him or her to have an impartial evaluation of present solvency and of the effects of the agreement on this person's future economic situation. Besides this, saying that it is superfluous to evaluate the consumer's solvency is really surprising if one considers that this is an elderly person who contracts a risky financial product, the economic outcome of which is contingent on factors such as the time this person will live, and for which, from the outset, the consumer loses the ownership of his or her primary residence, despite retaining the use thereof.

The transposition of the Directive into national law does not alter this situation, as very often legislators have merely transcribed the MCD. For example, this is the case of France,[4] Italy[5] and Spain. In the latter, Art. 2(1) of Law 5/2019, of 15 March (LCCI) practically mimics Art. 3(1) MCD and the same happens with regard to the exclusion in Art. 3(2)(a) MCD, which Art. 2.4(f) LCCI almost copies, albeit with a peculiar change of name that apparently greatly restricts the scope of the provision. Indeed,

[4] The Ordonnance no. 2016-351 that, among other laws, modified the French Consumer Code; especially, see the resulting Art. L313-2.

[5] The Decreto Legislativo 21 April 2016, no. 72, among other laws, modified the Decreto Legislativo 1 Aeptember 1993, no. 385 (Testo Unico Bancario); especially, see the resulting Art. 120-sexies.

the expression 'equity release credit agreements' used in the Directive, which can include different types of secured annuities, is replaced in the Spanish LCCI so that the exclusion only refers to the very specific institution of the reverse mortgage.

It should be pointed out that the different language versions of the MCD are not homogeneous in this respect, which does not clarify the meaning of the rule at all. Thus, 'equity release credit agreements' becomes 'pensión hipotecaria' in the Spanish translation of the Directive, which is correct, but becomes 'hypothèque rechargeable' in the French version, an expression that describes a special type of mortgage, different from the concept of equity release. Other versions of the MCD, as in the case of Italy and Portugal, complete the translation mainly adding '(equity release)', in English and in brackets. However, these deviations cannot alter the scope of the Directive, and it is clear that it cannot be applied, not only to reverse mortgages, but also to mortgage pension products and other equivalent specialised products; and neither do the Spanish LCCI nor other transposition laws.

The non-application of the MCD and the LCCI to the specific case of the reverse mortgage and other equity release products is open to criticism, since normally the contracts creating them are consumer relations, between a professional and a consumer, and there is no justification for excluding them from the protection measures articulated in this legislation.[6]

Despite this, in the specific case of the reverse mortgage, its exclusion from the national transposition laws does not have such drastic effects as in the case of the other equivalent specialised products, since consumer protection is not so affected, as in some cases legislators had already articulated some protective measures prior to the transposition laws; for example, this is the case of France and Spain, as will be discussed in the following section. However, the problem does arise in relation to other products, such as life annuities, which will also be addressed below (section IV).

III The Reverse Mortgage

1 Concept and Models

The so-called reverse mortgage is a mortgage that guarantees the restitution of a sum of money, the amount of which may be fixed and already known at the time of concluding the contract, or may increase over time through periodic payments; this debt is generally not due until the death of the debtor or, if so provided, of a beneficiary other than the debtor. It should be noted that when the debt is not due until the time of the death of the original debtor, the payment will be made by this person's heirs, who will occupy the deceased's position as debtor.

[6] Arnaiz (2021) 201-202, also criticises the exclusion of the reverse mortgage from the framework of the LCCI.

Despite the fact that some legal provisions use it, expressions like reverse mortgage or 'hipoteca inversa' in Spanish law do not seem to be very appropriate names, as they respond more to commercial and marketing criteria than to strictly legal ones.[7] Expressions like 'prêt viager hipothécaire' used by the French Consumer Code and 'lifetime mortgage' in English common law are more accurate.

There is a notable difference with the usual case of a loan secured by a mortgage, in which the amount of the secured obligation decreases over time as the debtor pays the debt, returning periodically part of the money originally received; in contrast, in the obligation secured by the reverse mortgage the holder of the encumbered property periodically receives a sum of money, so that the debt does not decrease over time, but increases with each periodic payment to the borrower, which is the usual case, and in general the restitution is not made by the original debtor, but by this person's heirs.

Reverse mortgages are usually taken out by elderly people, already retired, who, using their immovable property as collateral, contract with a bank to receive an annuity, which can be configured as temporary or for life, thereby ensuring the receipt of an additional income to supplement their public pension. When the borrower dies, the total amount received, plus interest, will be the total amount to be returned by the heirs who, having accepted the inheritance, are then owners of the property mortgaged as security for that obligation. It should be noted that in the case of the reverse mortgage there is an element of uncertainty as regards the final amount of the debt.[8]

There are two main models of reverse mortgage. The first one can be called a generic or atypical reverse mortgage, whose regime is that of the general regulation of the mortgages, with the peculiarity that the amount of the guaranteed obligation will not be specified initially, but at the end of the term of the contract, which is determined by the debtor's demise. The second model of reverse mortgage is that which, under this name, is mainly regulated and typified by a specific law, like the French Consumer Code or Law 41/2007 in Spain.[9] In the case of Spain, the regulation is minimal as far as the mortgage itself is concerned, as it is limited to establishing certain requirements, essentially of a subjective nature, which, if they are met, give rise to certain specific effects, mainly tax benefits and tariff reductions; if these requirements are not met, the reverse mortgage relationship will be subject to the general rules on mortgages.

[7] In this sense, Simón (2018) 163.

[8] Except in the unusual case in which the debtor receives an amount for money at the beginning of the relationship only.

[9] Arts L315-1 to L315-23 of the French Consumer Code; Additional Provisions 1 and 4 of Law 41/2007.

The following subsections focus on this second model of reverse mortgage and the special features it entails in relation to the general type of mortgage.

2 Purpose and Essential Elements

The reverse mortgage is an equity release product intended for the benefit of elderly people who need to supplement their income at a stage in their lives when they are particularly vulnerable.

Recital VIII, paras 3-4 of the Spanish Law 41/2007 describes the essential features of the reverse mortgage and its purpose in the following terms:

> 'The reverse mortgage regulated in this Law is defined as a mortgage loan or credit whereby the homeowner `draws amounts of money, normally periodically, although the drawdown may be a one-off, up to a maximum amount determined by a percentage of the appraised value of the property at the time of constitution. When this percentage is reached, the elderly or disabled person ceases to draw any amount of money and the debt continues to accrue interest. Recovery by the lender of the principal plus interest normally occurs all at once upon the death of the owner, through the cancellation of the debt by the heirs or the enforcement of the mortgage by the lender'.

The essential effects that the legislator intended with the regulation of the reverse mortgage in Law 41/2007 are essentially of a fiscal and tariff nature.[10] The few material alterations of the legal regime of mortgages in general will be discussed below.

While in France there is no age limitation in order to contract a 'prêt viager hypothécaire', in Spain both the applicant and the possible beneficiaries designated by the applicant must be aged 65 or over, therefore retired or about to be retired, or persons affected by situations of dependency or disability. It should be noted that despite these are people who have already seen, or will soon see, their income decrease, they quite often are the owners of residential property and, in particular, of the house or flat in which they live.

These properties can serve as assets to supplement their income and finance themselves at that stage without having to change their way of life, as they continue to own the property in which they live; from an emotional point of view, this makes the reverse mortgage attractive, as it means that the mortgaged asset will remain their property -although mortgaged- and in the future it will form part of their estate, which fulfils the interest of many people in being able to leave a certain amount of wealth to their future heirs.

[10] Additional Provision 1 (paras 7, 8 and 9) and 4 of Law 41/2007.

Because of the purpose of the reverse mortgage and because its recipients may sometimes be vulnerable people, both Spain and France have restricted the possible creditors to financial institutions and insurance companies.[11] As the Bank of Spain points out, 'this excludes other financial operators or even private individuals who are not subject to the control and supervision of the institutions responsible for ensuring transparency in this sector'.[12]

Likewise, the purpose of the reverse mortgage and the establishment of tax benefits that encourage its use require a very rigorous regime of transparency in its marketing and protection of the addressees. In particular, entities that grant reverse mortgages must offer independent advisory services to applicants for this product, considering the applicant's financial situation and the economic risks derived from taking out this product.[13]

3 Nature of the Secured Obligation

The common denominator of any obligation secured by a reverse mortgage is the repayment of a sum of money that the debtor has received during his or her lifetime, in a single payment or various instalments. Depending on the circumstances, repayment will be made by the debtor or, in the most frequent case, by this person's heirs.

The obligation secured by a reverse mortgage resembles a loan or credit, in a common sense of these institutions. However, in the strict legal sense this is not the case, since the dynamics of the obligatory relationship guaranteed by the reverse mortgage do not normally fit into the configuration of loan or credit granting contracts. Therefore, it may be surprising that both Art. L315-1 French Consumer Code or Additional Provision 1 of Law 41/2007, in general terms, describe that institution as a 'loan or credit', the amount of which is available to the debtor 'by means of periodic or single advances', i.e., a contract in which the lender undertakes to deliver a sum of money to be subsequently repaid by the borrower, which certainly does not always fit into the legal definition of loan or credit contract in some national Civil codes.[14]

The amount of the obligation is uncertain, as the amount to be received by the debtor is calculated according to this person's life expectancy and the value of the property. The longevity of this person may mean that, at a given time the maximum amount of the principal initially envisaged has already been reached. As a consequence, the

[11] Additional Provision 1, para. 2 of Law 41/2007 and Art. L315-1 of the French Consumer Code.
[12] Banco de España (2017) 13.
[13] Addtional Provision 1, para. 4 of Law 41/2007. Moreover, the Spanish Ministry of Economy specified this protection in Order EHA/2899/2011, of 28 October, on transparency and customer protection in banking services, subsequently updated.
[14] Art. 1740 Spanish CC and Art. 1892 French CC.

debtor will therefore no longer receive any more payments. This contingency is usually covered by taking out an insurance for a deferred life annuity, in which the insurance company will cover the annuities accrued from that moment until the death of the debtor. Logically, the existence of this insurance, the cost of which will depend on the age and state of health of the applicant, will have led to a reduction in the income received in the first phase of the operation of the reverse mortgage.[15]

4 Termination of the Reverse Mortgage Relationship

The reverse mortgage credit agreement may be terminated by different circumstances. Evidently, it can end for reasons applicable to rights *in rem* in general, and especially to security rights; for example, the agreement between the parties terminating the relationship, which will entail the payment of the debt accrued up to that moment and the cancellation of the mortgage. Despite this, the wording of the law seems to limit the causes of termination to two: the death of the debtor and the voluntary transfer of the mortgaged property.

The most common scenario, which can be described as characteristic of the reverse mortgage, is that it ends due to the death of the debtor, the recipient of the annuities. In this case, this person's heirs can either pay the entire accumulated debt, thus extinguishing the loan, or if they prefer they may not pay the debt and expose themselves to the creditor enforcing its right over the estate, including the mortgaged property.[16] The creditor cannot seize the heirs' assets, regardless of the manner in which the estate was accepted. Besides this, in France the creditor has also the possibility to obtain the ownership of the mortgaged immovable either by a court decision or by means of a *pactum commissorium* (Art. L315-20 French Consumer Code).

The second cause of extinction of the reverse mortgage is peculiar. Specifically, in the event that the mortgaged property is voluntarily transferred by the mortgagor, the creditor -the bank or insurance company- may declare the early termination of the secured loan or credit,[17] which means that the mortgage can be enforced[18]. This cause of termination is indeed a benefit for the mortgagee, because in fact it should be irrelevant to the lender who the owner of the encumbered property is, since the mortgage, being a property right, is not affected by the change. One consequence of this benefit for the creditor is that the debtor's position becomes more hazardous, and we must not forget that the debtor is usually a vulnerable person.

[15] On the combination of the reverse mortgage with an insurance for a deferred annuity, see Banco de España (2017) 16 and 21.
[16] Additional Provision 1, paras 5 and 6 of Law 41/2007.
[17] Additional Provision 1, para. 5 of Law 41/2007, and Arts L315-1 and L315-21 of the French Consumer Code.
[18] Art. 12 of the Ley Hipotecaria (LH).

As in the case of death, in France the creditor has also the possibility to obtain the ownership of the mortgaged immovable either by a court decision or by means of a *pactum commissorium* when the property is sold (Arts L315-20 and L315-21 French Consumer Code). In Spanish Law, there is an exception to the possibility of declaring early termination; specifically, when the debtor 'proceeds to the substitution of the guarantee in a sufficient manner' (Additional Provision 1, para. 5 of Law 41/2007). This text does not clarify what the criteria are, neither of substitution nor of sufficiency, which may raise important doubts; useful criteria would be to provide that it is sufficient to replace the guarantee by another real security or to offer joint and several liability of a credit institution.[19]

IV Life Annuities as Legal Structures to Monetise Immovable Property for Elderly Care

A life annuity is the right of one person to perceive from another a periodic amount of money during his or her lifetime. This right can be settled gratuitously, but in most cases, it will be the result of an onerous contract, in which the annuity is paid as consideration for some property, movable or immovable, transmitted by the borrower to the person that assumed the obligation to pay the annuity; if it was the borrower's home, the life annuity is an equity release product.

There are two main kinds of such life annuities, depending on the legal position of the new owner of what had been the primary home of the borrower:

a) Life annuities *in rem*, in which the owner of the immovable at any time is also the *debtor* of the annuity.

b) Life annuities *in personam*, or simple life annuities, in which the debtor is always the person who contracted the annuity, and the immovable, as belonging to this person, is only one of the assets that can be enforced upon in case of non-payment of the annuity. In this case, a third party that acquires ownership of the immovable is not responsible of the debt. The only exception is when the property was mortgaged as security for the annuity; in this case, a new owner of the mortgaged immovable does not become the debtor, but the immovable is still collateral for the obligation.

1 Life Annuities *In Rem*. The Catalan 'Cens Vitalici'

Life annuity *in rem* finds its origin in the classical institution of emphyteusis, still present, though with variations in its name, nature and effects, in several European civil codes. For example, in Italy, in case of transfer of the encumbered immovable,

[19] Argument *ex* Art. 569-11 Catalan CC for the substitution of right of retention. On this subject, see Pozo, Vaquer & Bosch (2023) 556.

the emphyteutic debtor is not discharged of the obligations toward the creditor, remaining as an *in solidum* debtor with the new owner (Art. 965 Italian CC).

The best example of life annuity *in rem* is the 'cens vitalici' of the Catalan CC, with a modern, clear and useful regulation rooted in the renovation of emphyteusis since the 1990s; Art. 565-1(1) Catalan CC defines the 'cens' as 'a periodic annual monetary allowance, of a perpetual or temporary nature, which is linked *in rem* to the ownership of an immovable property that guarantees payment directly and immediately'.[20] The Catalan CC fully reflects a modern configuration of the 'cens' as a property right over somebody else's immovable, the most visible manifestation of which is the payment of a periodic amount that is linked to this property, and can therefore be classified as an annuity *in rem*. This legal construction definitively puts an end to the historical configuration of the 'cens' as a divided ownership.

From the legal concept of the *cens* given in Art. 565-1(1) Catalan CC it is clear that by linking the annuity, in real terms, to the ownership of the property, its debtor (the 'censatari') will be whoever is the owner of the property at any given time. This means that in the 'cens' the debtor of the annuity changes with each transfer of the immovable, and for this the consent of the creditor (the 'censalista') is not required, which constitutes an exception to the principle that the creditor must consent any change that may be potentially detrimental to him or her.[21] This linking of the debtor to the ownership of the encumbered property, makes it possible to qualify the 'cens' as a real charge. Art. 565-9(2) Catalan CC, in relation to the sale of the property at auction as a result of its enforcement for non-payment of annuities, explicitly confirms this characteristic of the 'cens', stating that the person who acquires the property at auction acquires it encumbered with the 'cens' and assumes the obligation to pay the annuity until it is extinguished. We can see that the 'cens' also has the function of a real security,[22] but is not extinguished by its own enforcement and continues to encumber the property in security of future annuities.

The Catalan CC regulates two different types of 'cens', to which a series of common rules apply. Specifically, Art. 565-2 Catalan CC distinguishes between the 'cens emfitèutic' (emphyteusis) if it is constituted in perpetuity[23] and is redeemable at the will of the 'censatari', and the 'cens vitalici' (life annuity *in rem*), if it is constituted temporarily (for life) and as non-redeemable at the will of the 'censatari', without prejudice to the possibility of expressly agreeing redeemability. It is to the latter that we shall turn our attention, because of its recognised usefulness as an equity release

[20] On the institution of the 'cens' in general, and the 'cens vitalici' in particular, see Pozo, Vaquer & Bosch (2023) 467-481.

[21] See basically Art. 1205 Spanish CC.

[22] Thus, Arts 565-1(1) and 565-8(6) Catalan CC.

[23] Despite the wording of the law, the fixing of a specific term is not excluded. On this issue, see Pozo, Vaquer & Bosch (2023) 470.

instrument: on the basis of the primary residence, it ensures sufficient income and adequate housing for elderly people.

The typifying characteristic of the ‘cens vitalici’ is that its duration is established by reference to the life of one or two persons living at the time of its constitution (Art. 565-29 Catalan CC). This is particularly interesting, as it allows it to be constituted, for example, in favour of both spouses, and the ‘cens’ is only extinguished when the last of them dies. In this case, the share of the deceased spouse increases the share of the surviving one. Besides this, these persons do not necessarily have to be the creditors of the annuity; for example, a person may have agreed to receive the pension while his or her disabled spouse lives, with the aim of being able to meet the expenses that this situation generates.

We can observe that the ‘cens vitalici’ includes an important component of uncertainty. If the annuity is calculated on the basis of the value of the immovable and the life expectancy of the beneficiary, any unexpected alteration of these parameters will lead to a deviation from the contractual balance, which may become intolerable. This is why Art. 565-31(2) Catalan CC establishes a rule that corrects a specific case of flagrant contractual imbalance. Specifically, the ‘cens’ constituted has no effect if the person or persons on whose life it has been constituted die within the two months following the constitution as a result of an illness that already existed at the time of said constitution. This rule is correct, but the legislator should go further and introduce broader and more flexible criteria that should redress the rigour of randomness. For example, it would be worth tempering the ‘cens vitalici’ in which the beneficiary dies prematurely, or after a few years, long before the life expectancy envisaged; or on the contrary, when the beneficiary lives for many more years than expected and, in addition, the encumbered property has decreased in value, for whatever reason. In any case, the parties are free to include contractual terms foreseeing changes of circumstances other than those of Art. 565-31(2) Catalan CC.

Given its characteristics, it is clear that the life annuity *in rem* is an ideal instrument to cover the first interest of the elderly person, which is to ensure an income that will allow him or her to live comfortably for the rest of his or her life. However, by itself, this figure does not provide a response to the second interest of this person, which, as indicated at the beginning of this chapter, is to have a suitable home, which will normally be the one that until then was the primary residence. The response to this interest must necessarily be sought in other legal institutions that are compatible with the ‘cens vitalici’; quite rightly, the Catalan CC makes this possibility explicit, avoiding possible doubts. Specifically, Art. 565-33 Catalan CC allows the parties to agree ‘validly that the person who transfers the property in exchange for the annuity retains, for life or temporarily, a right of usufruct or of habitation over the same property, which are necessarily consolidated with the property when the ‘cens’ is extinguished’. The ‘censalista’ thus becomes the usufructuary or tenant of the immovable that had been his or her property until the moment when the ‘cens vitalici’ was constituted.

This ensures that, as usufructuary, the person will have adequate housing covered. In addition, the flexibility of the legal structure created is maximised, as the usufruct right allows the usufructuary to rent out the dwelling.[24] This can be very interesting in order to finance the cost of a care home, if after a few years this 'cens' holder and usufructuary is no longer in a position to live alone in what was his or her primary residence. In short, the 'cens vitalici', together with the right of usufruct (or whatever similar content has been agreed), creates a legal structure that meets the interests of the elderly person.

2 Simple Life Annuities. The Catalan 'Violari'

Simple life annuities, or annuities *in personam*, are the simplest equity release structures. Either gratuitously or, more often, in exchange for the acquisition of some property, the debtor agrees to pay an annuity to the creditor during the latter's lifetime. For example, an elderly person transfers ownership of his or her primary home to a bank, in exchange for a life annuity. We must note that the bank is a simple debtor, and that the immovable is not directly encumbered to the payment of the annuity; it is only one of the bank's assets, one more, that will be seized in case of non-payment, but without any preference.

Of course, as in all obligations, it is possible to create a security for payment of the annuity. In the example, the elderly person (creditor of the annuity) and the bank (debtor and present owner of the primary home of the senior person) may accept to create a mortgage upon this immovable that will guarantee the payment of the annuity.

Besides the annuity, if this property is the habitual residence, the purpose of maintaining the dwelling there can be achieved by reserving a right of usufruct, as in the case of the 'cens vitalici' referred to above.

The usefulness of life annuity for these purposes has made this a classical institution, present in most European legal systems. This is the case of France, where the contract of 'rente viagère' can be concluded, either gratuitously or for consideration, in exchange of money, other movables or immovables (Art. 1968 French CC). In case of non-payment of even a single annuity, the creditor cannot ask for the restitution of the transferred asset but can enforce its right against all the debtor's assets and, with the money obtained from their sale, perceive the income due (Art. 1978 French CC). The same regime exists in Italy,[25] Spain[26] and England.[27]

[24] See Arts 561-2(2) and 561-6(1) Catalan CC, especially.

[25] The 'rendita vitalizia'. See especially Arts 1872 and 1878 Italian CC.

[26] The 'renta vitalicia'. See especially Arts 1802 (though with a confusing wording) and 1805 Spanish CC.

[27] The 'home reversion' in English common law.

In Catalan civil law, the 'violari' or life annuity is the contract whereby 'one person undertakes to pay another a periodic annuity in money during the lifetime of one or more persons living at the time of constitution' (Art. 624-1 Catalan CC). We can observe that the nature of the 'violari' is merely personal, and its essence is a credit right to receive for life an annuity to be paid by the initial debtor and his or her heirs; this differs it from the 'cens vitalici' (life annuity *in rem*) which, as a real charge, is linked to the ownership of an immovable, which guarantees the payment of the annuities by whoever at any given time is its owner, and who is also considered to be the debtor.

It should be noted that if the 'violari' is created for consideration, the determination as to which party has benefitted in relation to the other will depend fundamentally on the duration of the life of the recipient and the amount of the annuity. As in the case of the 'cens vitalici', it seems appropriate to establish some criteria to moderate this uncertainty, beyond the minimalist criterion of Art. 624-7(2) Catalan CC, similar to the one of the 'cens vitalici', mentioned above. Assuming that there is a 'contractual risk inherent to contingent contracts',[28] nothing prevents freedom of contract from qualifying or modulating this risk within reasonable limits.

In accordance with Art. 624-6(3) Catalan CC, the payment of the 'violari's' annuity can be secured by means of a security right. If the security chosen is a mortgage, we must seek its regulation in Art. 157 LH,[29] in relation to the mortgage in guarantee of periodic annuities. This security guarantees the periodic payment of a certain amount of money. It does not guarantee, therefore, the restitution of a capital sum, which does not exist in this type of mortgage, but only the payments at each deadline. In the event of non-fulfilment of any of these periodic instalments, the creditor can enforce the mortgage to recover what is due at the time.

An essential characteristic of this mortgage is that, in the event of enforcement, it subsists and becomes a real charge, so that the person obliged to pay the annuity is the owner of the property encumbered by the mortgage at any given time. Specifically, Art. 157(3) LH provides that, in the event of enforcement, whoever acquires the property encumbered with the mortgage will do so 'with subsistence of the same and of the obligation to pay the annuity until its expiry'. This means that the acquirer not only assumes responsibility for the debt, due to acquiring a mortgaged property, but also becomes the debtor of the secured obligation.

Undoubtedly, the explanation for this configuration of the mortgage as a real charge is that if mortgage has been enforced upon the property it is because the debtor is insolvent, so it is almost certain that this person will never pay the future annuities

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[28] Expression of Art. 621-46(2) Catalan CC, in relation to the *laesio ultra dimidium*.

[29] In Catalan CC, a surprising series of cascading remissions finally leads to Art. 157 LH; see Arts 569-38 and 626-4(2)(3) Catalan CC.

that will accrue. Faced with this situation, the legislator opts wisely for the realistic solution of considering the purchaser of the encumbered property as the debtor of the obligation that motivated the foreclosure, i. e. the payment of the annuities, an obligation that, moreover, is reinforced by the subsistence of the mortgage, which should normally have been extinguished as a consequence of its own enforcement. We can observe how Art. 157(3) LH, by maintaining the mortgage itself subsisting, constitutes an exception to the principle established by Art. 134(1) LH which, in general, provides for the extinction and consequent 'cancellation of the mortgage that motivated the enforcement.

The consideration of the mortgage as a real charge is an exception introduced by Art. 157(3) LH only in the case of enforcement for non-fulfilment of the annuities of the 'violari', but not when the sale of the property takes place voluntarily. In this case, the mortgage is not extinguished either, but continues to encumber the property, so that the new owner of the immovable becomes liable for the debt. We must emphasize this: the new owner is liable, but does not become the debtor of the secured obligation. In short, the debtor of the annuities remains the same, and the mortgaged property, now belonging to the purchaser, can be enforced upon in case of the debtor's default, but the purchaser does not become the personal debtor; the new owner's liability will be limited to the mortgaged immovable, so it will not affect the rest of this person's assets.

This is the regime that can be described as orthodox, as it is perfectly in line with the general criteria of the legal system. In short, as a rule, in the case of voluntary alienation of the mortgaged property securing any type of annuity, the assumption of the debt by the acquirer only occurs by agreement of the debtor and the creditor.

V Conclusion: The Need to Include Equity Release Products in the Scope of the Directive, and Other Ways Forward

Reverse mortgages and life annuities are complex legal structures -on their own or together with other rights, such as usufruct- which significantly compromise the economic security and viability of the persons who enter into them in order to ensure a decent future in the last years of their lives. This is why the recipient of annuities and of the possible use of the property as a home needs absolute legal certainty. However, the above-mentioned legal structures present risks in this respect, risks that should be considered and minimised by the legislator.

For example, the possibility of early termination of the reverse mortgage when the mortgaged property is voluntarily transferred by the mortgagor, can be very detrimental to this person,[30] in general, this will be a potentially vulnerable senior person who contracted the reverse mortgage precisely because this person was lacking

[30] In this line, see Simón (2018) 174-175.

sufficient income to meet his or her financial needs, to maintain a decent standard of living.[31] In the event of early termination, it is very likely that this person will not be able to pay back the accumulated capital (the annuities received) and the new owner will lose the encumbered immovable, just sold as a result of mortgage enforcement. Of course, if the transmission of the property was for value, it is possible that the beneficiary obtained enough money to pay the debt, but this will not always be the case; for example, if the money was spent as a result of a family emergency. This will happen too if the transmission was by gratuitous title, for instance if it was a gift for a just married son. In any case, early termination is a risky situation, as it means that the elderly person is already considered, unexpectedly, as a debtor of the accumulated capital, which can make his o her financial situation truly unsustainable.

There is no doubt that the legal and economic security of this person is worthy of greater protection than that offered by the regulations concerning banking transparency such as those referred to in sect. III.2 of this chapter. Greater security would be achieved by subjecting the reverse mortgage to the MCD or to national laws that might offer a stronger protection; in the case of Spanish Law, the subjection to the LCCI would mean that the recipient could benefit from the protection measures provided by this law, especially those that focus on notarial advice.

Let us focus on it, too. Traditionally, notaries have fulfilled an important advisory function, as can be seen from the declaration of principles in Art. 1 of the Reglamento Notarial (RN).[32] According to this provision, notaries are not only civil servants, but also legal professionals, and therefore have the task of advising those who seek their services, especially about the most suitable legal means of achieving their lawful objectives.

This general statement is explicitly developed in the LCCI, in order to make it specific to its scope of application. In this respect, section IV of the Preamble to the LCCI includes notarial advice as the key element of its objective of transparency measures, laid down to guarantee that the borrowers have the necessary information at their disposal so that they can fully understand the economic and legal burden of the loan that they are going to obtain. Thus, the notary has the function of impartially advising the borrower, clarifying any doubts that the contract may raise, and of checking that all the requirements of the principle of material transparency have been fulfilled, especially those related to the most complex or relevant contractual terms.

The notarial advice described in the Preamble to the LCCI is given particular expression in Art. 15. Without going into unnecessary detail here, two points should

[31] Anderson (2021) 189, emphasizes the vulnerability of the consumers at whom the reverse mortgage is aimed.

[32] Decreto de 2 de junio de 1944, known as Reglamento Notarial, i. e. the regulation that organizes and rules notarial activity.

be emphasized. The first is the obligation of the borrower to obtain the advice *in person*. The second is that this face-to-face advice will be reflected in a report drawn up by the notary, without which the mortgage loan deed cannot be authorised; furthermore, this public document must include an identifying summary of the report, without which it will not be possible to register it in the Land Register.

The legal certainty and security of the whole process is of the maximum level, as it is controlled by an independent expert in law, the notary, obliged by definition to give unbiased advice. Though the role of the notary is not exactly the same in all legal systems, the implementation of the described duties could and should be applied in most European legal systems.

Moreover, and coming back to equity release products and other legal structures aimed at providing supplementary income for elderly people, the obligation of a notarial unbiased advice would create a perfect symbiosis between the interest of senior persons and those of banks and other financial institutions, as all of them would benefit from increased legal certainty.

There is no doubt that the reverse mortgage, excluded from the Directive and national laws of transposition, would benefit from a protection regime similar to the one in the Spanish LCCI.

Likewise, similar arguments can be applied to all kind of life annuities constituted for value and secured by the transferred property itself, either as a real charge or by a mortgage. In both cases, the elderly person transfers his or her property to a third party in return for a regular annuity; it is therefore a transaction for value the result of which is uncertain from the outset, as it is contingent on various factors, the main one being the duration of the creditor's life, and there is no doubt that these are risky operations.

Although from the point of view of their legal configuration life annuities are very different from the loan secured by mortgage to acquire ownership of a property, in fact their economic structure is very similar. In a strictly economic sense, all these cases involve the transfer of a property in exchange for a sum of money payable periodically. The difference between an ordinary mortgage loan on the one hand, and life annuities on the other, is that the amount of the former is not contingent, whereas in the latter it is, as they depend on the creditor's longevity. Another important difference from an economic point of view is who can be considered the strong and the weak party in the contractual relationship. If we look at the recipient of the periodic payments, in the case of the mortgage loan for house purchase, the recipient is the financial institution, which is undoubtedly the economically stronger party to the contract: the lender knows how much it will receive -without prejudice to variable interest rates- and has the certainty that it will receive it. On the other hand, in the case of life annuities, the recipient of the pensions will normally be the economically weaker party, mainly because of the uncertainty of the total amount to be received, as this depends of life duration.

Even if the payment of the annuities is guaranteed by the immovable itself, which was transferred and that is now encumbered by the 'cens vitalici' or the mortgage securing the 'violari', for example, the non-payment even of a single instalment will undoubtedly entail considerable inconvenience, uncertainty and worry for the elderly person. There is clearly a risk, and for an elderly person the risk is perceived as exponentially more serious.

It is surprising that faced with such similar economic structures, the Directive and national transposition laws such as the LCCI exclude reverse mortgages, life annuities and similar products, a field where further protection measures would be very useful and really appreciated by most of our fellow-citizens, and especially by elderly people in a vulnerable situation. In this sense, it would be very interesting to broaden the scope of the MCD, in order to develop and implement in it solutions like the notarial advice introduced by the Spanish LCCI, which goes far beyond the consumer protection rules provided for in banking sector legislation.

The final conclusion of this chapter is that it would be very useful, both from a social and legal point of view, to remove the exclusions of reverse mortgages and other equivalent products that are contained in the Directive. Besides this, further developments in legal security for the consumers, like the compulsory notarial advice, would be really appreciated.

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CHAPTER 4
THE OBLIGATION OF TRANSPARENCY IN THE MCD. A LAW AND ECONOMICS APPROACH

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I Introduction

The 2008 housing crisis had deep and long-lasting effects on financial markets, homeownership and household wealth, with millions of people facing mortgage enforcement and their home equity decreasing significantly. The crisis exposed systemic weaknesses in lending practices, in particular, a lack of transparency in mortgage contract terms and even predatory behaviour of lenders. Almost a decade later, the European Parliament enacted Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (MCD). Recital III of the Directive is particularly compelling:

> '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. Many consumers have lost confidence in the financial sector and borrowers have found their loans increasingly unaffordable, resulting in defaults and forced sales rising'.

The MCD aimed at enhancing transparency and improving consumer protection of one of the most significant contracts for consumers given its long-term nature and substantial proportion of income it usually represents.

This paper analyses, from a law and economics perspective, the incentives that the MCD's transparency regulations create for lender and consumer behaviours and how

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they shape the decision-making process. Even though the regulation in intended to promote *ex ante* comprehension of the contract terms, ultimately, it encourages *ex post* litigation over contracts. While this might seem counterintuitive, within the overall regulatory context, the outcome might represent a first-best solution for addressing the complexities of the market.

II The Rationale for Transparency: Information Asymmetry

General consumer regulations broadly define consumer contracts by the parties involved (professional and non-professional), rather than by their content, thereby applying to a number of contracts, ranging from the simplest to the most complex. Directive 2014/17 delineates one such specific contract that consumers may engage in by virtue of its scope.

One of the defining characteristics of consumer contracts, and thus one of the rationales for their specific regulation, is the inherent potential for a disparity between the parties involved -where one party is professional and the other is non-professional- thus jeopardising the equilibrium of contractual equality.

This phenomenon occurs across all contracts, but its presence is particularly relevant in certain contexts. Specifically, we are referring to financial contracts, broadly categorized as credit contracts, banking contracts, investment services, and the like, although in this paper the attention will be directed towards credit agreements secured by immovable property, carried out by professional lenders and consumers, the purpose of which is the acquisition of residential immovables.

In general, we find four main sources of asymmetric information in financial contracts, and, particularly in what interests us here, in credit contracts with immovable property collateral.

(A) Product type and pricing mechanism. Financial contracts as defined above and, in particular, bank loans secured by mortgages, inherently entail elements of risk and uncertainty due to several factors. (a) They involve long-term commitments with substantial financial stakes, often spanning decades and encumbering a significant portion of the borrower's assets. Consequently, borrowers, lacking other assets, become long-term debtors. (b) The pricing mechanism is notably complex. The pivotal factor determining pricing is the interest rate, which can adopt diverse forms such as fixed or variable rates. Variable rates further complicate matters by incorporating various parameters, including reference indices, the existence of interest rate caps or floors, as well as assorted amortisation mechanisms and associated expenses. (c) Furthermore, the uncertainty surrounding the evolution of interest rates and inflation compounds the complexity. These variables significantly influence interest rate determination, contributing to the uncertainty. Given these complexities, even a reasonably informed consumer encounters significant challenges in comprehending the pricing mechanisms. Moreover, the influence of economic variables, which are inherently unpredictable, worsens this challenge. As we will see later, managing uncertainty is also a challenge in itself.

(B) Financial innovation. Information asymmetry within the financial sector is compounded by ongoing financial innovations. Service providers cater to both large institutional clients and retail consumers, offering an extensive array of products and services and the also extensive use of derivative instruments. While these instruments are primarily designed for institutional clients such as investment funds, insurers, and pension funds to enhance risk management, certain derivatives, including interest rate swaps, currency-indexed mortgages, preferred shares, and subordinated debt, have also been marketed to retail clients. This proliferation intensifies the problem of retail consumers being able to perfectly comprehend the product they are contracting. In fact, the European Security and Markets Authority (ESMA) periodically warns of the dangers of these products. Recent concerns have arisen regarding the marketing practices of specific financial products.[1] Moreover, a considerable number of these products have become subject to legal proceedings, predominantly due to perceived lack of transparency or inadequate disclosure by banking entities.[2]

(C) Conflicts of interest. One of the fundamental requirements incumbent upon providers of financial products and services is the provision of comprehensive information to potential clients. In such instances, this information may include not only details about the products and services but also advice regarding the most suitable options tailored to the clients' specific needs. Consequently, a potential conflict of interest may arise for the supplier, who is obliged to both inform and advise the client, while simultaneously being constrained by the commercial policies of the company, which invariably prioritise marketing certain products over others. Indeed, the ESMA has issued several recommendations concerning the marketing of certain complex products.[3]

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[1] ESMA and NCAs to look at marketing of financial products, 16.01.2023. Available at: https://www.esma.europa.eu/press-news/esma-news/esma-and-ncas-look-marketing-financial-products

[2] For example, the Spanish Supreme Court decision of 8 July 2014 (ES:TS:2014:2666) declares void an interest rate swap contract entered into by a banking entity with consumers. This contract was signed in 2008 and had the objective of protecting consumers from increases in interest rates in relation to the mortgage loan that they had previously entered into. The interest rate swap is an extraordinarily complex contract in which nothing in particular is guaranteed. It is the exchange of the payment of a fixed interest for a variable interest (not necessarily linked to another contract referring to a principal that has not necessarily changed hands either), in which the payments are settlements of the differences between these two types of interest.

[3]ESMA/2016/902. Available at: https://www.handbook.fca.org.uk/L3G/MIFID/2016-902_statement_brrd.pdf; ESMA/2014/146. Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/ipisc_complex_products_-_opinion_20140105.pdf

(D) Lack of competition. It should be acknowledged that financial products and services pose inherent risks for providers, including the potential for clients to default on their obligations stemming from loans. Consequently, alongside the intense regulations governing these entities, there exists relatively limited competition among providers.

The provider not only possesses superior knowledge of the service or product being offered but also dictates the contractual terms. Consequently, a dual information asymmetry exists between the contracting parties, which regulatory frameworks aim to mitigate. In the case of the banking sector, this information asymmetry is particularly pronounced, prompting specific attention and measures from the European legislator, such as: CCD 2023, MCD and MiFIDII.

All these measures share the common goal of redressing the imbalance between consumers and financial/banking service providers. As will be shown, they all start from the classic perspective that this paper focuses on first: the duty of information, although there are other mechanisms to try to achieve this rebalance, which will also be addressed.

III Classic Perspective: Duty of Information

The European legislator has traditionally considered the consumer as *homo economicus*, that is, as an agent who makes rational decisions.[4] Therefore, the way to eradicate the information asymmetry is precisely by offering information to the consumer.[5]

The MCD similarly takes this perspective, although it adds a nuance, which is that, as well as the obligations to provide information, it establishes a duty of ethics. In this way, Art 7 establishes standards of conduct for suppliers and specifically states that providers must 'act honestly, fairly, transparently and professionally, taking account of the rights and interests of the consumers.' Likewise, the same article establishes that the remuneration policy will not offer incentives to assume more risks than the client can assume, and it incorporates measures to avoid conflicts of interest, in particular by providing that 'remuneration is not contingent on the number or proportion of applications accepted.' Art 9 establishes that the providers' employees must have an adequate level of competence and knowledge, in other words, they must have knowledge of what they sell. We see that these articles try to address the problems of asymmetric information indicated above.

[4] Méndez-Pinedo (2018) 577.

[5] For example, Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts established in Art 5 that 'in the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language'. In other words, it seeks to facilitate information to the consumer.

Regarding the duty of information itself, starting from Art 10, the MCD goes into detail about the information that must be made available to the client, from advertising, general information and pre-contractual information. Art 16, headed 'adequate explanations' provides that 'Member States shall ensure that creditors and, where applicable, credit intermediaries or appointed representatives provide adequate explanations to the consumer on the proposed credit agreements and any ancillary services, in order to place the consumer in a position enabling him to assess whether the proposed credit agreements and ancillary services are adapted to his needs and financial situation.'

As far as we are concerned here, the Directive addresses the problem of transparency by imposing more information obligations on the borrower and listing the items that service providers must provide to consumers. This information is intended to be adequate and the borrower must be able to understand it. An obligation is thus imposed on the lender without taking into account the decision-making mechanisms, in particular, the fact that the individual will not necessarily process all the information in a rational and logical manner.

At first, economic theory postulated that individuals make decisions rationally, which implies that they maximize their utility.[6] This implies that the individual: (a) has transitive and complete preferences, i.e. it has preferences over all possibilities and they are also ordered; (b) has complete information about preferences; and (c) is risk averse, that is, it prefers certain situations to those in which there is uncertainty (for example, he or she prefers EURO 50 to a lottery in which EURO 100 may be won, or nothing, with a probability of 50% respectively).

At first glance it becomes apparent that the theory of the rational individual cannot be fully realised: neither are our preferences strictly rational, nor is complete information readily available. Moreover, there is evidence to suggest that individuals are not simply risk-averse but rather exhibit loss aversion, indicating a preference to avoid losses rather than maximize gains.

However, the classical information perspective only addresses the problem of asymmetric information with the presumption that individuals are, indeed, rational and that having information will lead to making appropriate decisions. Furthermore, the management of uncertainty is essential in financial contracts. It is not just that these contracts are substantively complex, but that they require dealing with uncertain scenarios and making decisions in those scenarios. A correct approach to the concept of risk is essential since it is key to *truly understanding* what is being contracted: there can be no transparency for the consumer if he or she does not

[6] In this case we should not confuse 'utility' with selfishness: utility is everything that, in general, produces happiness and can include altruistic motivations, see Becker (1993).

assimilate the notions of risk, uncertainty and know their consequences and ramifications.

Therefore, when analysing how decisions are made under uncertainty, this fact must be considered. In this sense, the economics Nobel Prize-winning psychologist, Daniel Kahneman, proposes the concept of 'bounded rationality'. Thus, our brain has two ways of processing information: fast and slow. The fast one is intuitive, uses shortcuts to make decisions ('heuristics') and the slow one is rational and logical. It so happens that the vast majority of decisions are made with the fast system, so we do not process all the available information rationally but rather intuitively.[7] In other words, individuals do not act as the *homo economicus* that the classical theory proposes.

This gives rise to what are called 'psychological biases', such as overconfidence, confirmation biases, illusion of control or availability biases.[8] All of them prevent the processing of information exhaustively, but they must be taken into account given that they play an important role in decision-making and not just the fact of having all the information available. As Howells points out, no matter how clear the information contained in the contract is, it is still difficult for many consumers to understand said information.[9] For these reasons, although transparency in information is obviously essential, it will not be sufficient in many cases for effective consumer protection.

A crucial aspect of transparency is that it requires an active effort on the part of the professional who is in the position to design and write the general contractual terms.[10] In this way, the European legislator should supplement the classic perspective of information and introduce additional elements to rebalance the consumer's position, especially in more complex contracts such as those regulated by the MCD. Both this directive and others that also regulate complex contracts have tried to introduce alternative instruments and, as we will also see, they are attempts that undoubtedly go in the right direction, but that the European legislator has not yet fully committed to carry out with greater assertiveness.[11]

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[7] Kahneman (2003) 1469.

[8] See Thaler (2016), for further development of these concepts.

[9] Howells (2005) 359.

[10] An example of this is included in Art 80 of the General Law for the Protection of Consumers and Users (TRLGDCU) which provides that clauses not negotiated individually must be clear, concrete and simple in their wording, as well as accessible and legible. In this sense, the regulations establish that the letters must have a minimum size of 2.5 millimeters and have sufficient contrast with the background color. However, several studies indicate that companies do not necessarily have an incentive for transparency (Bienenstock (2016, 255)). Fraczek (2020) carries out an empirical study in which she demonstrates that many credit contract offers are not presented in a transparent manner and are not comparable with each other, so they would not even comply with the obligation of transparency.

[11] See, for instance, Arroyo Amayuelas (2017a) 3 and (2017b) 37.

IV Beyond Transparency: Other Instruments for Risk Assessment

1 Creditworthiness Assessment

Alongside the duty to provide information, the MCD includes another provision aimed at safeguarding consumer interests: the obligation to assess the borrower's creditworthiness. This requirement goes beyond transparency in the information, aiming at guaranteeing that borrowers are truly capable, from an economic standpoint, of fulfilling the obligations they are about to undertake. This is regulated in Art 18, and it constitutes a way of 'responsible lending'[12] that goes beyond the obligation of information.[13]

Art 18.1 MCD stipulates that 'Member States shall ensure that, before concluding a credit agreement, the creditor makes a thorough assessment of the consumer's creditworthiness. That assessment shall take appropriate account of factors relevant to verifying the prospect of the consumer to meet their obligations under the credit agreement.'

The Directive does not detail the specific methodology for conducting this evaluation.[14] However, Art 18(3) states that the assessment shall not rely predominantly on the value of the residential immovable property or the assumption that the residential immovable property will increase in value. The European Banking Authority (EBA) published shortly after the Directive was adopted a guide for the assessment of creditworthiness aimed at entities and in guideline 1 it stated that the creditor should make reasonable enquiries and take reasonable steps to verify the

[12] See, for example, the FSUG opinion and recommendations for the review of the Consumer Credit Directive, available at https://finance.ec.europa.eu/system/files/2019-04/fsug-opinions-190408-responsible-consumer-credit-lending_en.pdf or the Opinion of the European Banking Authority on Good Practices for Responsible Mortgage Lending (EBA/Op/2013/02) available at https://www.eba.europa.eu/sites/ default/files/documents/10180/604499/caf8cc3f-c8ec-4360-a5f3-243034ae2479/EBA%20Opinion%20on%20Good%20Practices%20for%20Responsible%20Mortgage %20Lending.pdf (last visit: September 2024) for other responsible lending practices. The EBA/Op/2013/02has been repealed on 21 March 2016 and has not been replaced but it still provides examples of responsible lending.

[13] Arroyo (2017a) 14 and Méndez- Pinedo (2018) 577.

[14] Although, as indicated by Livada (2019), it is more specific than CCD 2008, now repealed by CCD 2023, since it requires an obligation to deny the credit in the event that the evaluation is negative, despite the fact that both parties want to continue with the operation. CCD 2023 also requires that the assessment is positive in order to grant credit and, among other measures, grants the right to review the outcome by a human in case of automated processing of assessment as well as an explanation of the reasons that led to the outcome, see Arroyo (2024) 11 for details on the creditworthiness assessment in Directive 2023/2225.

consumer's underlying income capacity, the consumer's income history and any variability over time. [15]

The consumer's creditworthiness assessment, although part of the entity's own diligence in conducting it accurately, also requires the collaboration of the borrower to provide the relevant information. The Directive delegates to Member States the responsibility of regulating the procedure for assessing creditworthiness, as well as defining the repercussions of failing to do so.

While these aspects will not be explored here, as they are not the focus of this work, it is worth noting that the creditworthiness assessment process also entails transparency obligations for providers[16]. In particular, Art 20(3) MCD indicates that:

> 'Member States shall ensure that creditors specify in a clear and straightforward way at the pre-contractual phase the necessary information and independently verifiable evidence that the consumer needs to provide and the timeframe within which the consumer needs to provide the information […].'

Therefore, although the borrower has an obligation to provide information, said obligation must be specified in the pre-contractual phase in a clear and precise manner and said obligation will be fulfilled when the lender so requires. In essence, this brings us back to the obligations of information and transparency. However, these obligations inherently carry more significant implications. If the creditworthiness assessment yields a negative result, indicating that the borrower may struggle to repay the loan, the entity is obliged to decline the loan, as provided by Art 18(5)(a).

It is the provider that has the burden of ensuring that the information requested from the borrower is complete and that, effectively, this information provided conforms to what was requested, since the contract cannot be terminated when the information provided is incomplete (as long as it was not hidden or falsified), according to Art 20(3) MCD.

Thus, the Directive introduces a mechanism for assessing the risk of the transaction based on objective factors. These factors do not rely on subjective perceptions or

[15] Available at https://www.eba.europa.eu/legacy/regulation-and-policy/regulatory-activities/consumer-protection-and-financial-innovation-7. See also the compliance table, EBA GL 2015 11-CT-V3 GLs, last updated on 9 June 2021, in which countries express intention to comply with the guidelines. Avalaible at: https://www.eba.europa.eu/sites/default/files/document_library/964304/EBA%20GL%202015%2011-CT-V3%20GLs%20on%20Creditworthiness%20Assessment.pdf

[16] See Arroyo (2017a) 10 for further development of this topic.

awareness of risk but rather on elements that facilitate evaluating whether the borrower will be capable of repaying the loan based on their financial circumstances.

2 Other Personal Factors

Thus far, we have observed that the Directive seeks to address the disparity between lenders and consumers through classical approaches such as enhancing information provision and also by mandating lenders to assess the risk of default. Now, let us focus on potential subjective factors, specifically the actual knowledge possessed by consumers.

In fact, Art 6 of the Directive stipulates that Member States must promote measures aimed at educating consumers regarding loan agreements and debt management. However, as highlighted by Méndez-Pinedo,[17] financial education being the cornerstone of financial consumer protection is problematic, given that it has been demonstrated that this perspective has failed to prevent market failures or ensure consumer protection. In my opinion, this should not prevent efforts from continuing to be invested in financial education, but in parallel with other instruments that do ensure that consumers are protected effectively.

Furthermore, it is imperative to acknowledge that financial education, or the expectations we hold for reasonably informed consumers, should not solely rely on information provision as the means to rebalance asymmetries. It should also consider psychological biases, as discussed earlier, and their influence on decision-making processes.

Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments, commonly referred to as Mifid II, acknowledges the distinction between financially literate individuals and those who are not. It imposes varying obligations on financial service providers depending on the client's level of financial sophistication. Specifically, its Annex II defines a professional client as 'a client who has the experience, knowledge and qualifications necessary to make his or her own investment decisions and to correctly assess the risks inherent in such decisions.' Here the fundamental concept is being able to 'accurately assess risks', implying the capacity to make informed decisions in scenarios of uncertainty, which essentially implies operating with the principles of probability, a concept inherently complicated, as humans naturally seek certainty.

However, this approach is not without its challenges. Ultimately, the assessment of suitability and creditworthiness must be conducted by the service-providing entities, which, as previously mentioned, may harbour conflicts of interest. Nonetheless, it represents an initial step towards recognizing that consumers of financial products

[17] Méndez-Pinedo (2008) 577.

possess distinct needs and characteristics compared to consumers in general, or rather, they share the same traits but psychological biases have greater relevance.[18]

V Final Remarks: *Ex Ante* Transparency v. *Ex Post* Action

Ideally, transparency should be ensured prior to the conclusion of the contract, allowing the borrower to have a full understanding of its contents. However, the complexity of mortgage-backed loan contracts, especially their operation under conditions of uncertainty, means that, in practice, the problems related to them and their potential lack of transparency are being addressed *ex post*, when they are judicially challenged (interest rate floor clauses, contract expenses, reference indices).

As previously mentioned, providers lack sufficient incentive to voluntarily provide information that may not be readily available to consumers, necessitating legal mandates for transparency. Nevertheless, in practice, the obligation of transparency places the burden on the consumers to become experts on each object or service for which they contract and both with regard to the relevant characteristics of the object of the contract and of the contractual terms.

Information is only useful if you can act on it and, as Howells points out,[19] it takes time to assimilate it and, furthermore, studies suggest that only the middle and upper classes would benefit from more information. Additionally, and this is particularly true in the sector here analysed, the alternatives are few (we have commented on the lack of competition in the sector), so increasing the amount of information, *ex ante*, may not balance the situation of the consumers. The new regulations regarding mortgage loans and consumer credit do not appear to deviate significantly from this trend. While they emphasize the provision of abundant information to the client, there is no guarantee that the client will necessarily comprehend it better.

Consequently, disputes arising from such contracts are likely to end up in court, *post facto*, once the contracts have been concluded. While this may seem suboptimal, as ideally consumers should enter into contracts fully informed, it only represents a deferred cost. If there are unfair terms in the contract, consumers will need to either inform themselves *ex ante* or litigate in the future.

This presents challenges, as it relies on consumers being aware of potential abuses and taking legal action accordingly. Indeed, Directive 93/13 on unfair contract terms specifies in its Recital 4 that:

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[18] See, for example Mak and Braspenning (2012) for a study of how financial education influences decision making.
[19] Howells (2005) 358.

> 'it is the responsibility of the Member States to ensure that contracts concluded with consumers do not contain unfair terms', and in Art 6, it states that 'Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.'

Thus, the consumer protection system itself presupposes this *ex post* action.

Nevertheless, this should not impede ongoing advancements in financial education nor impede consumers from acquiring knowledge and comprehension of the complex contracts more common in our system. However, it is essential to acknowledge and address the psychological biases when regulating. For example, some authors[20] propose using the default rules of consumer regulations in favour of consumers (for example, using cooling-off periods or the prohibition of door-to-door sales[21]), increasing banking regulation (although not typically part of consumer protection regulations, crucially relevant in this context). Not all tools will fit all types of contracts, but the bottom line is that regulation must ensure that the lender internalises the cost it generates for the consumer.[22]

Therefore, the European legislator must persist in its efforts to rebalance the consumer's position through transparency. However, this effort must always be complemented with other mechanisms to ensure that transparency effectively and positively impacts this objective.

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[20] Howells (2005) 365.

[21] Directive 2005/29 concerning unfair business-to-consumer commercial practices in the internal market applies to credit agreements that fall within the scope of the MCD, as per its Recital 37. However, authorities should remain vigilant, and identify potential unfair practices as well as effectively enforcing the regulation.

[22] Both the *ex ante* cost of obtaining and understanding the contract terms and the *ex post* cost of litigation.

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CHAPTER 5

THE NEW UK CONSUMER DUTY: MORE RESPONSIBLE MORTGAGE LENDING?

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I Introduction

The Mortgage Credit Directive, along with all consumer-focussed legislation, looks to strike a 'right' or 'fair' balance between the rights and responsibilities of the contracting parties, in this case lender and borrower. The previous volume, *The Impact of the Mortgage Credit Directive in Europe*[1] charts the journey to the Mortgage Credit Directive (MCD) which in the United Kingdom (UK) was preceded by the domestic reforms introduced by the Financial Conduct Authority's (FCA) Mortgage Market Review (MMR) that followed the global financial crisis of 2007/8. That part of the UK journey was examined in Chapter 5 of that volume. Since then, the UK has left the European Union but, along with the rest of Europe, has suffered the economic and social dislocation of the COVID global pandemic, the slowdown in the global economy, war in Europe, high inflation and the associated cost of living

[1] Anderson & Arroyo Amayuelas (2017).

crisis. It has responded by immediate measures to alleviate these shocks but has also taken a distinct turn with the introduction of a new consumer duty (Consumer Duty) that looks to an outcomes approach rather than the process-driven methodology of the MCD and the MMR. The primary focus of this outcomes approach to the responsibility balance is the suitability of a mortgage to a borrower's needs.

This chapter will look at this new Consumer Duty and seek to evaluate its likely impact upon the continuing journey to rebalance the responsibilities of lender and borrower in the light of changing economic and social conditions. It will argue that the Consumer Duty does introduce a changed dynamic between mortgage providers, their intermediaries and consumer borrowers which has the potential to recalibrate the mortgage relationship with the greatest potential influence on addressing certain harmful mortgage products —equity release products being a prime target. Sadly, other vulnerable borrowers, particularly mortgage prisoners, are unlikely to benefit. However, the nature of the Consumer Duty, as a higher-level principle, inevitably only addresses a relatively small part of the risk landscape that a borrower faces. It is thus not a panacea but a building block in this wide-ranging and complex relationship.

The chapter will begin by providing an overview reminder of the salient features of the lender-borrower relationship and its regulation in the UK. It will then look at the Consumer Duty itself providing both an account of the evolution of the Consumer Duty as well as its detailed elements. We then look at the likely impact of the Consumer Duty on the lender-borrower relationship within which we focus on three case studies that have generated particular concern, these being equity release products, interest-only mortgages and the mortgage prisoners' scandal. The chapter concludes with our final evaluation of the Consumer Duty.

II The UK Regulatory Approach to Consumer Mortgages

The 2008 financial crisis precipitated a protracted debate over consumer protection. That crisis, which had its roots in irresponsible mortgage lending, exposed gaps in the consumer protection framework and illustrated the limits of the neoliberal assumptions underpinning the regulation of financial services in the UK. It became evident that information disclosure coupled with largely unsuccessful attempts at consumer education were inadequate to address market imbalances and promote 'rational' decision making, whether by borrower or lender, upon which neoliberal market-led regulation depends. As a result, the MCD and the MRR targeted irresponsible lending through the introduction of affordability checks with added stress testing, restrictions on interest-only lending and a shift to advised sales; all measures which shifted some responsibility for borrower's decision making onto mortgage providers. But consumer groups pressed for further reform.

To appreciate the impetus for these calls for further consumer protection and the Consumer Duty that has emerged, as detailed in section III, it is important to recall the principal features of mortgage borrowing and the UK regulatory landscape that seeks to address the associated risks. These features are examined in some detail in Chapter 5 of the previous volume, *The Impact of the Mortgage Credit Directive in Europe*[2] and so it is only the key aspects that will be highlighted here.

1 Mortgages as Financial Products

Mortgages display various characteristics which impinge directly on a borrower's ability to make rational decisions and thus successfully meet the neoliberal ideal of competitive markets where parties' self-interested decision making ensures that 'good' products thrive whilst 'poor' products fail. These characteristics justify rebalancing the responsibility dynamic with strong consumer protection in which the Consumer Duty may play a useful role.

Mortgages are long-term credence products, being products of which the consumer has little to no prior knowledge or experience, and thus whose suitability it is difficult for a borrower to assess. Mortgages are entered into for extended terms of 20, 30 or even 40 years so a borrower may only experience one mortgage in their lifetime and furthermore have limited opportunities to change to a more suitable product. Yet the consequences of poor decision-making can be severe and jeopardise the borrower's and their families' residential security. By contrast mortgage providers have extensive experience of the market and so can predict the consequences of their lending decisions. Information disclosure and consumer financial education can only make limited inroads into this lack of experience and thus Wightman has argued that the sellers of credence products should owe a quasi-fiduciary duty to take responsibility for the suitability of their goods.[3] The rationale for a strong Consumer Duty is thus justified even if it falls short of a full fiduciary duty.

Money is borrowed for a reason, and it is often this reason that is uppermost in the borrower's mind when entering into a credit agreement. In the case of a regulated mortgage[4] that reason is frequently to buy a home and ensure a level of residential security that is not equalled by alternative housing tenures. In the UK the private rental sector is precarious and there is an acute undersupply of social housing. The possibility of capital accumulation offered by mortgage-funded home ownership is an added incentive to mount the housing ladder with the attraction of a better funded retirement and later life social care as well as the prospect of passing on that capital to future generations. All in all, the borrower frequently has the purchase of a future home and capital asset foremost in their decision making rather than assessing financing options. The role of mortgage finance in housing policy is thus key and could

[2] Nield (2017).
[3] Wightman (2003).
[4] FCA regulated mortgages are first or subsequent mortgages secured on a dwelling. Buy-to-let mortgages are largely excluded. For a definition see Financial and Services Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544.

justify its characterisation as a life sustaining 'lifetime contract'.[5] It certainly justifies high levels of protection which underpin the Consumer Duty and a sensitivity to the behavioural economics that influence a borrower's decision-making and which the Consumer Duty is beginning to acknowledge.

A mortgage is an unusual financial product in that lenders perform their contractual obligations at the inception of the mortgage relationship by advancing the loan. Continued performance lies with the borrower's repayment obligations. The lender's exposure to the risk of borrower default is also minimised in three respects. First, they have the security of the mortgage itself over the borrower's home, which will only be exposed by high loan to value ratios coupled with a fall in the housing market. Secondly, their own borrowing costs are usually short term and can be reflected in the variable interest rates they charge the borrower. In the UK interest rates are usually only fixed for a maximum of 5 years, exposing borrowers regularly to the risk of increased borrowing costs during the mortgage term. Lastly, the lender can securitize their mortgage debts, generally to institutional investors, to whom the risk of default is transferred. By contrast, the borrower is much more exposed to the risk of unforeseen events which can disrupt the flow of income upon which mortgage repayments depend. It is often impossible for the borrower to insure against these risks —only the risk of critical illness is insurable. Other personal life events, for example relationship breakdown or loss of employment, may leave the borrower unable to make repayment but with only limited state support available. This imbalance in the allocation of risk justifies the forbearance policies that emerged with the economic crisis of 2008 and have developed through the COVID 19 pandemic and the cost-of-living crisis that has followed. How lenders respond to default, particularly by vulnerable borrowers, is also central to the Consumer Duty.

2 Regulatory Principles, Rules and the Direction of Regulatory Travel

The FCA has the central regulatory role for consumer protection and market conduct.[6] Its overall strategic objective is to ensure that the markets it regulates, including the consumer mortgage market, are functioning well.[7] Its operational objectives are defined as securing an appropriate degree of consumer protection, to protect and enhance the integrity of the UK financial system and to promote effective competition in the interests of consumers.[8] It do so by licencing financial service providers, setting of conduct of business standards through overarching principles and detailed conduct of business rules, monitoring compliance with those standards and taking enforcing action where necessary .
Consumer redress is primarily provided through the Financial Ombudsman Service (FOS) who offers alternative dispute resolution with financial redress based upon

[5] See Ratti (2018) 332.

[6] See the Financial Services and Markets Act 2000 (as amended), hereafter referred to as FSMA 2000.

[7] FSMA 2000, s. 1B(2).

[8] FSMA 2000, s. 1C(I), 1D(I) and 1E(I).

what the FOS decides is 'fair and reasonable in all the circumstances'.[9] This service is free to the borrower and can lead to compensation of up to £415,000, although the FOS will not generally interfere with established property rights.[10] The regulatory work of both the FCA and the FOS is subject to judicial oversight through judicial review of their decision making.[11]

2.1 Principles-Based Regulation

The FCA's regulatory approach is said to be 'Principles-based' rather than relying on detailed prescriptive rules that can lead to game playing avoidance. Instead, qualitative principles seek to set higher level standards of conduct to which mortgage providers are expected to adhere, although how they reach these is left to individual firms to decide and implement.[12] Accordingly, the Principles tend to be outcome based, with considerable emphasis on the responsibility of the mortgage providers' senior executives and managers to ensure the firm's business model and conduct meets those principled outcomes. Principled based regulation is said to have the advantage of being sufficiently broad to cater for a wide range of financial services and situations and is sufficiently flexible to address changing circumstances.[13]

The FCA's regulatory Principles, which apply to regulated firms, are found in the FCA's Handbook.[14] For example, they require regulated financial service providers to conduct their business with integrity[15] and with due care, skill and diligence[16] and to treat their customers fairly, [17] to communicate information in a manner which is clear, fair and not misleading[18] and to take reasonable care as to the suitability of their advice.[19] The inherent uncertainty of these principles is to some extent offset by guidance published by the FCA.
Although the MMR and the MCD provoked a raft of reforms, the continuing influence of neoliberalism is clear in the set of factors to which the FCA is to have regard when determining the appropriate level of consumer protection. Amongst these factors is the counter-balancing principle that consumers should take responsibility for their decisions.[20] This principle has long proved controversial with consumer rights

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[9] FSMA 2000, s. 228.
[10] See for example *Thakker v Northern Rock* [2014] EWHC 2107.
[11] See Nield (2017) 174-184.
[12] For a fuller explanation see Black, Hopper & Band (2007).
[13] Although it has been subject to criticism even by its proponents see Black (2012) 1042-1045.
[14] See https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html
[15] Principle 1.
[16] Principle 2
[17] Principle 6
[18] Principle 7.
[19] Principle 9.
[20] FSMA 2000, s. 1C(2).

advocates, as explained in the next section. To an extent it is mitigated by the new Consumer Duty, which operates as an additional high-level principle.[21]

2.2 Principles: Rule Dynamic

The FCA's 'Principles-based approach' is hybridised by detailed conduct of business rules found in the Conduct of Mortgage Business Handbook (MCOB), which set out detailed rules governing each step of a borrower's journey from pre-sales promotion, information and advice and affordability criteria, to post sale conduct of the lender-borrower relationship.[22]

The interrelationship between the Principles and MCOB is significant. The Principles have been described as 'the ever present substrata'[23] on which the more detailed conduct of business rules depend; accordingly, they must always be complied with. They are not supplanted by, but augment, the specific rules, so that compliance with MCOB will not necessarily satisfy the Consumer Duty Principle.

A key distinction between the Principles and MCOB, however, rests upon their enforceability. The Principles are not directly enforceable by a borrower. They operate instead at a regulatory level to direct the FCA's monitoring, disciplinary and enforcement work as well as being an influence upon the FCA's overarching regulatory initiatives, be that market studies or targeted campaigns. By contrast, a breach of MCOB does give rise to a borrower's right of action for breach of statutory duty,[24] although it is cheaper and swifter for a borrower to bring a complaint to the FOS.[25] The FOS can also prompt FCA's regulatory action. Indeed, the FCA sees the monitoring of FOS decisions as a key element of measuring 'the success' of the Consumer Duty.[26] Accordingly, these decisions could have a key influence on lenders' conduct.

2.3 The Direction of Regulatory Travel: Vulnerability and Borrowers in Financial Difficulty

Two further pieces of regulatory work that preceded the introduction of the Consumer Duty are of interest to the extent that they feed into and inform the Consumer Duty. First, is the FCA's guidance on the treatment of vulnerable

[21] Principle 12.
[22] See MCOB accessible at https://www.handbook.fca.org.uk/handbook/MCOB (accessed 15/04/24).
[23] *R (on the application of British Bankers Association) v FSA* [2011] EWHC 999 at [162].
[24] FSMA 2000, s. 138D.
[25] See for example *Thakker v Northern Rock* [2014] EWHC 2107.
[26] PS22/09, para 1.21. Available at https://www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty

consumers[27] and secondly, the Mortgage Charter[28] and the FCA's policy and guidance on Strengthening Protections for Borrowers in Financial Difficulty.[29]

No doubt influenced by the seminal Vulnerability Theory developed by Martha Fineman,[30] the FCA recognises that vulnerability represents a spectrum of risk. We all can be vulnerable to harm, but some have greater capabilities to address, or at least reduce, those harms. Thus, the FCA has accepted that all consumers of financial services are potentially vulnerable, but that vulnerability is more likely to be exposed by poor physical or mental health, life events including new caring responsibilities, low resilience to economic or life shocks and low capabilities such as literacy or numeracy skills. The FCA conducts periodic Financial Lives Surveys that have demonstrated high levels of vulnerability, particularly following the COVID 19 pandemic.[31] The FCA Guidance on Vulnerable Consumers sets out what is expected of financial service providers to address potential consumer vulnerabilities. The essential features of this guidance look to understanding the needs of vulnerable consumers and responding to those needs, through the design of financial products, the communications with and support offered to vulnerable consumers by staff that are capable and (if necessary) trained to deliver that support. Continued monitoring and review of the adequacy of these measures are also highlighted. We will see these elements running through the Consumer Duty.

With the COVID 19 pandemic and the cost-of-living crisis there has been a focus on supporting borrowers in financial difficulty. Tailored Support Guidance was issued in response to the pandemic, and we are seeing that welcome aspects of this forbearance initiative continued both through the Government's Mortgage Charter and PS24/2. The Mortgage Charter was promoted by the Government as a political response to the cost-of-living crisis with the main mortgage providers signing up. It made some, but not significant, changes to the forbearance measures already found in MCOB 13.[32] PS24/2 is of more import as direct evidence of what the FCA considers to be the fair treatment of borrowers in financial difficulty and amends MCOB13.[33] As such it, and the associated guidance, inform what the Consumer Duty entails for borrowers in financial difficulty.[34] The significant changes are that support should be offered to

[27] FG21/1 available at https://www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf (accessed 26/04/24).
[28] See https://www.gov.uk/government/publications/mortgage-charter/mortgage-charter (accessed 29/03/24).
[29] PS24/2 available at https://www.fca.org.uk/publication/policy/ps24-2.pdf and the associated guidance see FG24/2 is available at https://www.fca.org.uk/publication/finalised-guidance/fg24-2.pdf (both accessed 21/04/24).
[30] See Fineman (2008); Fineman & Greer (2013).
[31] See Financial Lives Surveys of 2017, 2020, 2022 and 2023. The latter concentrated on the cost of living accessible at https://www.fca.org.uk/financial-lives
[32] See PS23/8 available at https://www.fca.org.uk/publication/policy/ps23-8.pdf
[33] See PS24/2 available at https://www.fca.org.uk/publication/policy/ps24-2.pdf
[34] They are due to come into force on 04/11/24 as a successor to the Tailored Support Guidance.

borrowers who are at risk of default, not just those who are in default. That support should be enhanced with clearer disclosure of payment shortfalls, a wider range of forbearance options, and generic debt advice.

III The Consumer Duty

The Consumer Duty has its roots in the 2008 financial crisis and dissatisfaction with the extent of the changes to the regulatory framework resulting from the MMR and MCD. Consumer groups and the Financial Services Consumer Panel (FSCP) argued that these changes did not go far enough towards protecting consumers. They contended that too much emphasis was still placed on consumer responsibility and not enough on the responsibility of firms to ensure their products were 'appropriate for the consumer in terms of meeting their needs, accessibility and reasonable value for money'.[35] The ensuing debate brought to light a range of poor business practices by financial firms, exposed the limits of existing consumer protection standards and led to demands for a new Consumer Duty. This section begins by outlining the origins of this new Consumer Duty and makes the point that concern over consumer harms in the mortgage market was a factor in the push for reform. It then explains the content of that duty, drawing on illustrative examples from the consumer mortgage market, before discussing some emerging themes.

1 The Emergence of the New Consumer Duty

Consumer rights advocates have long argued that the FCA principle that consumers should take responsibility for their decisions[36] was particularly problematic because it failed 'to take into account the imbalance in power between firms and their customers, information asymmetries, and low levels of consumer financial capability'.[37]

Indeed, the FSCP went further arguing that the consumer responsibility principle actually undermines consumer protection by enabling firms to provide consumers with 'reams of documents' as a way of discharging their disclosure requirements and then assuming that responsibility is transferred to consumers, 'as they should have read these documents'.[38] It also criticised the emphasis on consumer responsibility as

[35] House of Commons, House of Lords, Joint Committee on the draft Financial Services Bill (2011) paras. 114-117, available at https://publications.parliament.uk/pa/jt201012/jtselect/jtdraftfin/236/236.pdf

[36] FSMA 2000, s1C(2)

[37] FSCP, *Incorporating a Duty of Care into the Financial Services & Markets Act* (2015) 1.

[38] House of Commons, House of Lords, *Joint Committee on the draft Financial Services Bill* (2011) para. 114, available at https://publications.parliament.uk/pa/jt201012/jtselect/jtdraftfin/236/236.pdf para. 114.

being at odds with empirical evidence of widespread poor consumer understanding and financial literacy.[39]

In 2011 the FSCP proposed that the consumer responsibility principle should be counterbalanced by the introduction of a new statutory fiduciary duty of care that authorised firms would have to their clients.[40] This was inspired by US reforms and, in particular, by the fiduciary duty established under the Dodd-Frank Act, which required firms to put the interests of consumers first and to ensure there are no conflicts of interest.[41] The FSCP argued that a similar duty should also provide consumers in the UK with a private statutory right to pursue damages for negligent firm behaviour through the courts.[42]

The FCA did not initially consider that a new Consumer Duty was necessary. It pointed out that the FCA rules already contained Principle 6, which required firms to treat customers fairly.[43] Nevertheless, the FCA recognised the limitations of Principle 6 when it accepted that consumers 'cannot currently bring civil claims based on an alleged breach of Principle 6'.[44] While the FCA rejected the proposal of a new duty, it launched a discussion paper on the topic.[45]

In the subsequent debate, the FSCP argued that Principle 6 was ineffective at preventing consumer harms because it 'does not remove conflicts of interest' and so did not 'deter firms from mis-selling products and services'.[46] It argued that Principle 6 only enshrines a weak duty to the consumer' which was 'further weakened by the legal principle in FSMA that consumers should 'take responsibility for their decisions'.[47] In making the case for reform, the FSCP pointed out that the financial services industry 'has frequently sold inappropriate products on an industrial scale to customers who were later revealed not to have been properly informed of the risks involved, or, in some cases, were entirely unaware they had purchased the product at all'.[48]

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[39] House of Commons, House of Lords, *Joint Committee on the draft Financial Services Bill* (2011) para 115, available at https://publications.parliament.uk/pa/jt201012/jtselect/jtdraftfin/236/236.pdf para. 115.
[40] FSCP, *Response to A new approach to financial regulation: Building a stronger system, April 2011* (2011) 9-10.
[41] FSCP, *Response to A new approach to financial regulation: Building a stronger system, April 2011* (2011) 9-10.
[42] FSCP, *Response to A new approach to financial regulation: Building a stronger system, April 2011* (2011) 9-10.
[43] FCA, *Our future Mission* (2016) 24.
[44] FCA, *Our future Mission* (2016) 24.
[45] FCA, *Our Mission 2017* (2017) 26.
[46] FSCP, *A duty of care for financial services providers* (2017) 1.
[47] FSCP, *A duty of care for financial services providers* (2017) 1.
[48] FSCP, *Incorporating a Duty of Care into the Financial Services & Markets Act* (2015) 3-4. Some examples can be found in the widespread mis-selling of endowment mortgages and payment protection insurance.

The FSCP supported this critique by drawing attention to various harmful business practices, including in the consumer mortgage market. It pointed out that mortgage lenders kept 'captive customers on higher SVRs [Standard Variable Rates]' and failed 'to offer them the ability to move to cheaper fixed rates'.[49] They also identified how mortgage advisers are 'not required to take consumers' debts or benefit entitlements into account when advising on equity release products'.[50] Furthermore, it pointed out that while mortgage providers must ensure equity release is suitable for consumers when the product is taken out, they are 'not required to carry out additional checks when consumers draw down funds from a reserve facility, which can be many times larger than the original loan'.[51]

Following these debates, the FCA concluded that the existing regime of consumer protection was not effectively preventing customer harm because it did not place sufficient emphasis on the needs and objectives of the end consumer. It accepted that firms 'sometimes exploit consumers behavioural biases, e.g. by not being fully transparent in the information they provide'.[52] It also identified instances of firms engaging in, what it referred to as, 'sludge practices' whereby firms 'introduce excessive friction in their processes that prevents consumers from making decisions in their interests'.[53]

Accordingly, the FCA proposed introducing a new Consumer Duty that would ensure firms focused more proactively on delivering good consumer outcomes.[54] Such a change, it contended, could help to improve the levels of trust that consumers have in financial services.[55]

Although consumer rights advocates can claim some success in winning the argument for reform, the Consumer Duty is quite different from the initial demands they made. The Consumer Duty is not a fiduciary or statutory duty but rather involves a change to the FCA's Principles. Nor does it provide consumers with an individual right of action against firms for breach of the duty.[56] While the FCA came to the view that this was not currently appropriate, it has committed to keep the possibility of a private right of action under review.[57]

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[49] FSCP, *A duty of care for financial services providers* (2017) 3.
[50] FSCP, *A duty of care for financial services providers* (2017) 3.
[51] FSCP, *A duty of care for financial services providers* (2017) 3.
[52] FCA, *A new Consumer duty, Consultation Paper CP 21/13* (2021) para. 2.9.
[53] FCA, *A new Consumer duty, Consultation Paper CP 21/13* (2021) paras 2.10-2.11.
[54] FCA, *A new Consumer duty, Consultation Paper CP 21/13* (2021), paras 2.16-2.18.
[55] FCA, *A new Consumer duty, Consultation Paper CP 21/13* (2021), para. 2.16.
[56] FCA, *A new Consumer duty, Feedback to CP21/13 and further consultation, Consultation Paper CP 21/36* (2021) paras. 12.12-12.21.
[57] FCA, *A new Consumer duty, Feedback to CP21/13 and further consultation, Consultation Paper CP 21/36* (2021) para. 12.21.

2 The Consumer Duty

The Consumer Duty is introduced as a high-level Principle 12 that guides the delivery of all financial services business including regulated mortgage contracts. To an extent this duty replaces the Principle 6 ('to pay due regard to the interests of their customers and treat them fairly')[58] and Principle 7 ('to pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading'). These previous principles both played a significant role in the delivery of FCA's consumer focussed regulation, but it is intended that the Consumer Duty will hold mortgage providers and intermediaries to 'a higher and more exacting' standard.[59]

The Consumer Duty has a wide ambit and applies to new and existing regulated mortgage products that are offered to borrowers, including prospective borrowers.[60] It applies to both mortgage providers and their intermediaries, indeed all who have a material influence upon the experience of borrowers under a regulated mortgage contract. This might include, for example, a debt recovery agency involved in possession or other enforcement proceedings. It does not have retrospective effect and does not apply to past actions. However, it applies, in a forward-looking manner, to existing mortgages products, for example to address any generic aspect of that mortgage product which may breach the duty or to address any harm suffered by an existing borrower.[61]

The FCA has developed detailed guidance on how the new duty is to affect financial services providers.[62] This guidance elaborates how the Consumer Duty comprises three elements; namely, the core Consumer Principle, which sets the overall expected standard of behaviour; the Cross-Cutting Rules, which detail three overarching requirements intended to explain how financial service providers are to deliver the Consumer Duty, and lastly, the Four Outcomes which provide 'a suite of rules and guidance' covering the key elements of the financial services providers relationship with their clients.

Underpinning each of these elements is the concept of 'reasonableness' as an objective test of the standard which could reasonably be expected of a mortgage provider, or

[58] Principle 6.
[59] FG22/5 at para. 1.21.
[60] It came into operation from 31/07/23 for mortgages products sold after that date and from 31/7/24 for mortgages products no longer offered for sale after 31/07/23 but where the mortgage relationship is continuing (i.e. closed products).
[61] FG22/5, paras 3.4-3.9. From July 2024 the duty also affects mortgage products that are no longer offered for sale (closed products) but where there is a continuing mortgage relationship that falls foul of the duty
[62] FCA, Finalised Guidance FG22/5 issued pursuant to s139A of the FSMA 2000 available at https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf

intermediary, offering the same product or services with the necessary understanding of the needs and characteristics of borrowers within that target market.[63] This paper now turns to look at each of these three elements in more detail. It becomes evident that there is a good deal of overlap and interaction between them.

2.1 The Consumer Principle

The core principle enshrined within this duty is that a mortgage provider or intermediary should deliver good outcomes for their borrowers. The hope is that an outcomes focus will make mortgage providers think more about the experience of their borrowers and 'place [borrowers'] interests at the heart of their activities'.[64] It sets an almost biblical expectation that mortgage providers would ask: 'Am I treating my customers as I would expect to be treated in their circumstances?'[65]

They thus need to appreciate how borrowers 'actually behave and transact in the real world'[66] and 'have the flexibility to support [borrowers] … so they get good outcomes'.[67] Here there will need to be an understanding of behavioural biases and of housing expectations and aspirations as well as how borrowers experience personal financial shocks such a loss of employment, illness and relationship breakdown. But understanding will not be enough. Support is also required to ensure borrowers take on suitable mortgage products that meet their circumstances and to try and minimise borrowers' harm should those circumstances change adversely.

Despite this shift in focus, the guidance underlines that the lender-borrower relationship remains commercial. It does not create a fiduciary relationship where a lender would be expected to place their borrowers' interest centre stage and avoid any conflict with their own interests.[68] Borrowers remain responsible for their decisions, but their choices should be informed and effective, in the sense of made in their individual interests and financial objectives. There are still overtones that protection is market driven with mortgage providers 'competing vigorously in consumers' interests' and are incentivised to 'adapt and innovate' to meet changing markets conditions and needs.[69]

Throughout the published guidance there is a concern with the position of vulnerable borrowers, both in the generic sense that all borrowers are vulnerable to a change in financial circumstances, whether of their own or others' making, and in dealing with vulnerabilities of groups of borrowers, for example emanating from their age, financial

[63] FG22/5, para. 1.4.
[64] FG22/5, para. 4.3.
[65] FG 22/5, para. 4.4.
[66] FG22/5, para. 4.8.
[67] PS22/09, para. 1.3.
[68] FG22/5, para. 4.12.
[69] PS22/09, paras 1.3, 1.7.

literacy or physical or mental wellbeing. This reflects the FCA's earlier guidance on the fair treatment of vulnerable customers, which dovetails with the equality duties imposed by the Equality Act 2010.

2.2 The Cross Cutting Rules

In performance of the Consumer Principle to deliver good outcomes for their borrowers, the FCA expects mortgage providers and intermediaries to act in accordance with the three cross-cutting rules. They should act in good faith, to avoid foreseeable harm and to enable and support borrowers to pursue their financial objective, i.e. to borrow money or obtain financial support for a particular purpose. These rules apply both generically in the sale of regulated mortgage contracts and also individually in interactions with individual borrowers during the entry into and performance of the mortgage relationship.
These cross-cutting rules are:

A) Good Faith: A duty of good faith may be familiar to civilian lawyers, but common lawyers are not so conversant with the concept save when considering fiduciary relationships. The FCA characterises the duty as calling for 'honesty, fair and open dealing and consistency with the reasonable expectation' [70] of borrowers and as such focusses upon intent. It recognises 'the imbalance in bargaining position, knowledge and expertise' between borrower and lender so that borrowers 'can only reasonably be expected to take responsibility for their choices and decisions if [mortgage providers] act openly and honestly'.[71] Here is an element of lenders' responsibility to take account of a borrowers' interests and not exploit their lack of expertise or any behavioural biases.

B) To Avoid Foreseeable Harm: The guidance envisages that mortgage providers might cause foreseeable harm either proactively, for example in setting unrealistic repayment expectations, or through failing to engage with borrowers in repayment difficulties. The harm must be foreseeable and is underpinned by the limiting concept of reasonableness already referred to. Foreseeability seems to reflect ideas of causation and may also arise because a borrower does not fully understand the obligations under the mortgage or how those obligations may change over the course of the mortgage term. Here the guidance calls for an awareness of borrowers' behavioural biases. A lack of adequate support may also lead to foreseeable harm.

C) Enable and Support Borrowers to Pursue their Financial Objectives: This element of the rules engages with the purpose of mortgage borrowing and as such it reflects the outcomes focus of the Consumer Duty. For many borrowers the purpose of borrowing will be to buy a home and ensure their and their families residential

[70] FG22/5, para. 5.6.
[71] FG22/5, para. 5.7.

security. There may be other purposes, for instance, income generation in retirement, financial restructuring through consolidation of previously unsecured debts or to raise business finance for small and medium size businesses where the borrowing calls for a mortgage over a director or shareholder's home.

The rule looks to positive engagement throughout the full term of the mortgage relationship. A particular focus will arise should the borrower fall into arrears and the mortgage provider considers repossession. As discussed earlier, the MCOB already requires forbearance, the conditions of which have been updated by the Mortgage Charter and PS24/2. There is also a call for mortgage providers to direct potential borrowers to alternative sources of support and information where they decline to offer finance.[72]

In pinning down what support is envisaged, the guidance talks of mortgage providers 'creating the right environment' to enable borrowers to make decisions which are in line with their financial objectives, with sensitivity again to behavioural biases and to borrowers' vulnerability.[73] Other facilitative elements look to 'the design' of the mortgage encompassing its detailed terms, including interest rate, prepayment, portability, as well as effective communication and customer support, which appear also as vital elements of the four outcomes to which this chapter turns now.

2.3 The Four Outcomes

The FCA's Four Outcomes align closely with the cross-cutting rules and comprise, first, the products and services outcome; second, the price and value outcome; third, the consumer understanding outcome, and finally, the consumer support outcome.

A) The Products and Services Outcome: This outcome requires firms to ensure their product or service is designed to meet the needs, characteristics and objectives of customers in the target market, that the intended distribution strategy is appropriate and to carry out regular reviews of its continuing suitability.[74] Whilst essential features of a mortgage are well known, innovative detailed terms are always emerging, particularly regarding the calculation and recovery of interest. The guidance focusses on whether products are, and continue to be, fit for purpose, and as such this outcome dovetails with the cross-cutting rules that look to financial objectives and avoidance of foreseeable harm. It is recognised that this outcome is also influenced by the mortgage distribution network in which mortgage intermediaries play a vital role and increasingly involves elements of virtual engagement rather than personal contact.

[72] FG22/5, para. 5.40.
[73] FG22/5, para. 5.38.
[74] FG22/5, para. 6.3.

An additional feature is the emphasis on mortgage providers identifying a target market for a particular mortgage product with an appreciation of this market's characteristics, risk profile and capacity to understand the complexity of the mortgage and its terms. Within this target market the guidance calls for an appreciation of the likely vulnerability of targeted borrowers. It quotes, for example, their 2020 Financial Lives Survey which identifies 46% of adults (or 24 million people) in the UK as showing one or more characteristics of vulnerability[75] and the evidence which suggests that minority ethnic adults and those with disabilities are disproportionately likely to be in vulnerable circumstances or poverty.[76]

B) The Price and Value Outcome: Under this outcome, firms are required to ensure the price the customer pays for a product or service is reasonable compared to the overall benefits the customer will experience. Firms are expected to proactively assess whether the pricing structure could lead to foreseeable harm, whether fees are unjustifiable/unreasonable, whether changes in the benefits of the product are reflected in the price and whether changes in the assumptions that underpin pricing have been reflected in changes to the price.[77]

The cost of mortgage credit is generally competitive and tied to some external benchmark. There are thus market controls on the level of interest rates. The key pricing issues thus generally revolve around variation of those rates as keenly demonstrated by the steep rise in interest rates at the end of 2023 and their continuing high levels. Variation also may be triggered by the ending of initial incentivised rates. It is thus the cost over the whole term that is the proper subject of scrutiny together with the impact of other prepayment, late payment and other charges.[78] Stress testing interest rate rises seeks to address the crystal gazing that is required to assess long term repayment obligations, but inevitably these predictions can fall short.

C) The Consumer Understanding and Support Outcomes: The consumer understanding outcome directs firms to support their customers by helping them make informed decisions about financial products and services and the consumer support outcome requires firms to assist consumers in using the products and services they have purchased. There is a close relationship between these two outcomes and thus they are considered together.

The guidance articulates this relationship as being that whilst mortgage providers should communicate with borrowers 'in a way that equips them to make effective, timely and properly informed decisions', consumer support should enable borrowers 'to act on these decisions without facing unreasonable barriers'.[79] As a practical

[75] FG22/5, para. 6.26.
[76] FG22/5, para. 6.33.
[77] FG22/5, para. 7.8.
[78] FG22/5, paras 7.33, 7.39.
[79] FG22/5, para. 9.4.

indicium of this relationship, the guidance also calls upon the quality of post-sales support to be as good as pre-sales support and with similar response times.[80]

These outcomes continue the long-standing Principle 7 that mortgage providers 'communicate information in a way which is clear, fair and not misleading'. But they are said to go further by focussing on a borrowers' understanding of those communications and to 'equip [borrowers] to make decisions which are effective, timely and properly informed'[81] and which 'maximises the likelihood of a [borrower] achieving a good outcome'.[82] The call is for the communicator to 'put themselves in their [borrowers] shoes'.[83] There are suggestions that the required standard will most likely be met by communications which are layered, from key to more detailed information, engaging, relevant, simple and well timed.[84] There is also a prompt that the communicator should not 'exploit [borrowers'] information asymmetries and behavioural biases'.[85] The presentation, as well as content, of information is also important and should 'not [be] hidden within a large volume of material, or hard to find on a website'.[86] The role of digital support is acknowledged, and even accepted as adequate, in some circumstances. However, it is difficult to see how digital support could be considered adequate in the mortgage context when a borrower and their family's residential security is at stake. The prospect of a borrower, who has lost their job and consequently defaulted, trying to engage with a computer bot is surely unacceptable.

The guidance also calls for tailored communications which take account of borrowers' differing characteristics, both within a targeted group or of an individual borrower, whether arising from their vulnerability, the mortgage product's complexity, the communication channel employed or the role of the communicator in the borrower's mortgage journey. Rather sobering research is quoted which reveals that one in seven adults have literacy skills at or below those expected of a 9-11 year old and 34% of adults have poor to low levels of numeracy.[87] There are also duties under the Equality Act 2010, already referred to, which can impact upon communication, for example, to provide information in an accessible format. It is not expected however that communications should be tailored to the understanding of an individual borrower unless that individual is seeking specific information or explanation.[88]

[80] FG 22/5, paras 9.5-9.6.
[81] FG 22/5, paras 9.5-9.6.
[82] FG 22/5, para. 8.9.
[83] FG 22/5, para. 8.9.
[84] FG 22/5, para. 8.13.
[85] FG 22/5, para. 8.10.
[86] FG22/5, para. 8.12.
[87] FG22/5, para. 8.34.
[88] FG 22/5, para. 8.37.

The guidance talks positively about 'friction' in a borrower's decision making as appropriate moments to enable a borrower to think carefully about the decision they are about to make. But on the other hand, decries 'sludge' practices which, intentionally or unintentionally, discourage borrowers from seeking support or making a complaint.[89]

The interplay with regulatory disclosure, for example ESIS, is acknowledged but it is apparent that the latter is by no means sufficient.[90] Consumer support needs to be available throughout the term of the mortgage, from the sales process to the end of the mortgage term, and will need to be particularly evident during periods when a borrower is experiencing repayment difficulties.

To meet these communication and support aspirations the communicator is expected to test, monitor and, if necessary, adapt their practices.

IV The Impact on Regulated Mortgages

During the debates over the new Consumer Duty, it tended to be assumed that borrowers are well protected in the mortgage market and any concerns around consumer mortgages were not a significant driver behind its development. However, it is clear that the Consumer Duty is likely to have a significant impact on the consumer mortgage market for at least four reasons. First, the new duty involves a change in the FCA's guiding principles and, as such, it applies to all aspects of the regulation of financial services, including consumer mortgage markets. Second, the general critiques of the FCA's regulatory assumptions about markets and consumer behaviour that animated reform can also be applied to the consumer mortgage market. Third, as discussed in section II, consumer mortgages are an unusual financial product that involve long-term arrangements, acute imbalances of power between lender and borrower, and which carry particularly significant risks for consumer harm.

Finally, although consumers have significant distinctive legal protections in the consumer mortgage market, the FSCP have identified consumer harms and poor consumer outcomes in certain segments of the market, particularly in relation to equity release products, interest-only mortgages and the mortgage prisoner's scandal. In this section, the impact of this Consumer Duty upon regulated mortgages is outlined, by considering, first, the impact upon the conduct of mortgage providers business generically, and then by considering its impact in relation to three case studies involving mortgage products that cause particular concern.

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[89] FG22/5, paras. 9.19-9.25.
[90] FG22/5, paras. 8.14-8.19.

1 The Operation of the Consumer Duty

As already noted in section II, in the UK's hybridised principled based approach to financial regulation, the Consumer Duty operates as a higher-level Principle. The new duty has not yet spawned any amendment to the directly enforceable MCOB rules which govern the lender's conduct of business; however, the FCA has made clear that the Consumer Duty will guide and influence its regulatory and disciplinary actions.

In its CEO letter to mortgage lenders, the FCA clearly stated that it sees the Consumer Duty as marking 'a significant shift in our expectations of firms' which sets 'higher expectations of the care that firms give their customers' and its embedding in the culture and purpose of mortgage lenders should be 'a top priority'.[91] Mortgage lenders have been warned not to be complacent or over confident that their existing practices meet Consumer Duty expectations. They need to review and monitor every part of their business to see whether they meet the required outcomes and commit adequate resources to address any shortcomings. This is not a once and for all exercise but a continuing element of how lenders conduct their business.

The FCA also has announced that the Consumer Duty is 'a cornerstone' of their forthcoming strategy and will be embedded into their supervisory work.[92] It conducts periodic compliance reviews resulting in published guidance on what improvements have been recorded and areas where more needs to be done.[93]
Key areas where the FCA is calling on mortgage lenders to be vigilant concern consumer understanding and support where mortgage lenders are warned to tailor their communications and support to the individual circumstances and vulnerabilities of affected borrowers.[94] Three circumstances are highlighted. First, those borrowers experiencing repayment difficulties. Second, where a borrower is coming towards the end of a fixed rate period, and needs to decide about future borrowing. For instance, there have been reports of borrowers having to make hasty, and thus possibly ill advised, decisions as mortgage lenders make and withdraw offers in a short space of time.[95] Lastly, there are communications with borrowers considering consolidating their debts, for example, by entering into a second mortgage, because of cost-of-living pressures. There is concern that such borrowers may not always appreciate the implications of securing these debts on their home over a longer term.

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[91] FCA, Letter to CEO/Directors 3rd February 2023 available at https://www.fca.org.uk/publication/correspondence/consumer-duty-letter-mortgage-lenders-administrators.pdf

[92] FCA, Letter to CEO/Directors 3rd February 2023.

[93] See https://www.fca.org.uk/publications/good-and-poor-practice/consumer-duty-implementation-good-practice-and-areas-improvement

[94] FCA, Letter to CEO/Directors 3rd February 2023 Annex 2 available at https://www.fca.org.uk/publication/correspondence/consumer-duty-letter-mortgage-lenders-administrators.pdf

[95] See for instance https://www.bbc.co.uk/news/business-68574065

2 Assessing the Impact of the Consumer Duty: Three Case Studies

The impact as well as the potential and limitations of the new Consumer Duty can be further assessed by focussing upon the particular challenges presented by three case studies involving equity release schemes, interest only mortgages and mortgage ‘prisoners’. These three case studies have been selected because they involve instances of significant consumer harm and, in some cases, have already been targeted by the FCA.

2.1 Equity Release Products

The FCA expects that the new consumer duty is likely to have a significant impact in the equity release mortgage market. This expectation stems from the complex nature of equity release products and the characteristics of targeted borrowers. These products are commonly sold to the elderly, often to fund retirement or some capital expenditure, and can play upon these borrowers’ desire to stay in their home. Poor practices have too often been employed by firms and advisors that have produced significant consumer harm.

Equity release is a form of mortgage product that enables a consumer to withdraw money from the equity in their home without having to move home. The most common form of equity release product is the ‘lifetime mortgage’. Under a lifetime mortgage the principal is not repaid until the borrower dies or moves into long-term care and thus any repayments are made on an interest-only basis or, where the borrower is short of income, interest is added to the capital and thus compounded. Some schemes also provide for equity financing with the lender entitled to participate in any increase in the value of the property. Under a home reversion plan, the borrower sells all or a share in their property to a specialist entity who then leases the property back to the borrower at a nominal rental. The sale is generally below market value and again the financing company will benefit from any increase in the value of the property.

In recent years, there has been rising demand for equity release products in the UK. Such products are used by consumers to repay existing mortgage debt, to pay for home improvements (and increasingly energy-efficiency improvements), to consolidate burdensome debts, and to reduce working hours and facilitate earlier retirement.[94]

The FCA carried out its first investigation into equity release products in 2020 when they concentrated on lifetime mortgages. Its findings were very worrying.[96] The FCA found a high risk of consumer harm, for example, from the limited advice given of alternative and more suitable borrowing vehicles, poor returns where short-term benefits were wiped-out by the long-term costs of equity release, substantial early

[96] For a more detailed and independent consideration of equity release products see Fox O’Mahoney (2012).

repayment charges and inflexibility when circumstances changed. Its key findings were a lack of personalised advice, insufficient questioning of borrowers' assumptions about equity release and a lack of evidence to support the suitability of any advice.[97] Although firms were called upon to address these shortcomings, it is evident from the FCA's more recent investigations published in 2023 that lenders have continued to fall short in their marketing and sales of equity release products.[98]

This subsequent review found many inaccurate or misleading promotions with 400 promotions subsequently removed or amended. Equity release benefits were highlighted but without any balancing description of the associated risks. There was also evidence of lenders using their FCA regulated status to promote their equity release products, leading to borrowers' over-reliance of the suitability of these products. The FCA expressed disappointed that its 2020 findings had not been satisfactorily addressed, with continued evidence of inadequate consideration of the borrower's financial circumstances, poor discussions of alternatives, steering borrowers to lifetime mortgages or to products with attractive sales commissions but not necessarily good borrower outcomes.

What is of particular interest is the use of the Consumer Duty to guide, persuade and incentivise providers to address these shortcomings. The FCA underlines the need for providers to give clear and fair communications that do not mislead but provide appropriate and timely information that enables potential borrowers to decide whether a lifetime mortgage or reversion plan, and the associated terms, are best suited to their needs. Conversations also need to be balanced with a consideration of other suitable options. To do so, lenders are warned that they must gather all relevant information to tailor advice to their client; generic illustrations will not do.

The FCA has also focused upon fair value and bona fide in sales' commissions and set out that advisors must ensure they have 'appropriate processes to manage potential conflicts of interest and the risk of biases' and ensure 'that commission received from providers is not prioritised over customers receiving good value'. Finally, they must 'monitor and regularly review the outcomes their consumers are experiencing in practice and take action to address any risks to good customer outcomes'.

The FCA has placed considerable faith in the ability of the Consumer Duty to challenge longstanding poor practices by firms and advisors that have generated significant consumer harms. It is clear that the Consumer Duty raises standards around the provision of suitable advice and the design of promotional products. However, given the persistent poor business practices in this segment of the consumer

[97] See https://www.fca.org.uk/publications/multi-firm-reviews/equity-release-sales-and-advice-process-key-findings
[98] See https://www.fca.org.uk/publications/multi-firm-reviews/action-needed-ensure-good-outcomes-later-life-mortgage-borrowers

mortgage market, much will depend upon enhanced regulatory supervision and proactive enforcement by the FCA.

2.2 Interest-Only Mortgages

Interest-only mortgage products present a clear risk of harm to borrowers looking to fund the purchase of their home. The defining feature of such products is that the borrower's monthly payment covers only the interest charges on the loan and do not pay off any of the sum originally borrowed. Instead, the borrower will repay the full mortgage amount in one lump sum at the end of the term of the loan or when the property is sold. Thus, interest-only mortgage products may appear cheaper to the borrower because of the lower monthly repayment, but the borrower is in danger of having to sell the home at the end of the mortgage term to fund repayment of the capital sum.

Prior to the 2008 financial crisis, roughly a third of all mortgage sales had been made on interest-only terms. The MMR did lead to restrictions on the sales of interest-only mortgages to circumstances where the mortgage provider had assessed affordability on a full principal and interest basis and furthermore was satisfied that there was a credible principal repayment strategy beyond the sale of the borrower's home.

However, there remained the problem of interest-only mortgages that had been entered into before these prudent measures were imposed. Commentators have described these existing interest-only mortgages as a 'ticking time bomb'.[99] Early FCA Guidance did little more than suggest that mortgage providers make early and repeated contact with affected borrowers to encourage them to convert to a full repayment terms or resort to some other principal repayment vehicle.[100] Indeed, as discussed in the next case study, many of these borrowers holding interest-only mortgage products have become mortgage prisoners.

Subsequently, FCA has paid more attention to the scale of the interest-only mortgages problem with commissioned research into the problem conducted in 2018 and 2022. The number of interest-only mortgages has steadily reduced where borrowers have been financially able to respond to calls by mortgage providers to switch to full repayment terms or put in place an alternative principal repayment vehicle. By 2022,

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[99] Including Martin Wheatley, one-time Chief Executive at the FCA in answer to questions by the Treasury Select Committee in 2012 available https://www.thisismoney.co.uk/money/mortgageshome/article-2276457/How-stop-ticking-time-bomb-mortgage-detonating.html

[100] FG13/7 available at https://www.fca.org.uk/publications/finalised-guidance/fg13-7-dealing-fairly-interest-only-mortgage-customers-who-risk

9% of mortgages were interest-only with just over half of these taken out before the 2008 financial crisis.[101]

Nevertheless, there were still 1 million interest-only mortgages at the end 2022. These borrowers are likely to be those less financially able to address the principal repayment and, with the rise in interest rates, can only have come under increased financial pressure. Indeed, research suggests that financially strapped borrowers have been increasingly attracted to interest-only mortgages, with attendant concerns expressed by mortgage brokers that these prospective borrowers do not fully understand the implications of interest-only borrowing.[102] Furthermore, it cannot help borrower perception of the risks presented by interest-only mortgages that a standard forbearance device is to switch for a period to interest-only repayment.

However, updated guidance of how mortgage providers should treat these interest-only borrowers is yet to emerge. What is evident is that the FCA sees the Consumer Duty as prompting an increased focus on these vulnerable interest-only borrowers. A working group has been set up with a view to exploring alternative strategies and to update the FCA guidance to lenders.[103] It is also envisaged that, in response to the Consumer Duty, mortgage providers should explore how their interest-only borrowers can be more effectively supported. There is no suggestion in any of these initiatives that borrowers' contractual repayment obligations should be reduced because of the effective miss-selling of interest-only mortgages to borrowers whom mortgage providers knew had little to no prospect of being able to repay the principal advanced except by selling their home. The emphasis has been on strategies to ensure that these contractual repayment obligations can be met or varied, for instance, to allow time for full performance.

2.3 Mortgage Prisoners

The mortgage prisoners scandal provides an important case study which sheds light on the limitations of the Consumer Duty as it applies to consumer mortgages and exposes gaps in the consumer protection framework. The mortgage prisoners' scandal is a particular problem in the UK and Ireland where, unlike much of the rest of Europe, most mortgage products sold have an introductory deal for a fixed period of between 2-5 years, usually at a fixed interest rate. After this expires the rate changes to the Standard Variable Rate (SVR), which tends to be significantly higher than the

[101] Opinium, Interest Only Mortgage Research (January 2023) available at https://www.fca.org.uk/publication/external-research/interest-only-mortgages-research-opinium.pdfand accessed 27/02/24 and FCA, Research Note, Interest-only Mortgages: analysis of FCA data (August 2023) available at https://www.fca.org.uk/publication/research-notes/interest-only-mortgages-analysis-fca-mortgage-data.pdf

[102] Opinium ibid.

[103] See https://www.fca.org.uk/firms/fca-and-industry-working-group-interest-only-mortgages

fixed rate introductory deal.[104] It is typical for borrowers in the UK to remortgage, with all the costs this involves, instead of staying on the SVR.

The mortgage prisoners' scandal was a consequence of the 2008 financial crisis. A number of UK lenders collapsed, and their mortgage books, often containing interest-only mortgages, were nationalised and transferred to UK Asset Resolution (UKAR), a publicly owned body.[105] UKAR then transferred these loan portfolios to vulture funds 'to get a return for taxpayers'.[106] The vulture fund, which owns the mortgage, are not regulated by FCA but the loan-service companies (third party administrators, TPAs), which manage the loans, are regulated and subject to MCOB and the Consumer Duty.[107] Crucially, neither vulture funds nor TPAs are active lenders and so do not offer cheaper fixed rate mortgage products to borrowers.

The problem for the borrower, who purchased these mortgage products is compounded by the fact that they are often unable to switch to a cheaper fixed deal with active lenders in the UK market. This is because the MMR and MCD regulatory reforms required lenders to be more cautious. They could no longer offer high loan-to-value or debt-to-income loans and interest-only loans. Furthermore, lenders had to conduct stricter affordability assessments and so were reluctant to offer cheaper deals to mortgage prisoners.[108] The net effect of these changes was the creation of 'a class of borrower that could not easily remortgage' or switch to another lender and instead became 'trapped' paying higher repayment costs, at the SVR.[109] In 2021, the FCA estimated that 'there were about 195,000 households in closed mortgage books and/or had mortgages owned by firms not regulated by the FCA'.[110]

The FCA has responded to the mortgage prisoners' scandal by focusing on improving the ability of mortgage prisoners to switch to another lender.[111] In particular, the FCA introduced a voluntary modified affordability assessment that enabled 'active lenders to switch the products of existing borrowers without requiring the more stringent affordability assessment [...] as long as the customers were not looking to borrow more money'.[112] This change had very little impact in practice and the FCA estimates that 'around 200 borrowers' were helped to switch because of this change.[113] It found that

[104] FCA, *Mortgage Prisoners Review* (2021) paras 2.1-2.8.
[105] House of Commons Library, *Mortgage prisoners* (2023) 11-16.
[106] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020) 2.
[107] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020) 2. Although they did not sign up to voluntary measures, such as the Mortgage Charter.
[108] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020) 2.
[109] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020) 2-3.
[110] Scanlon, Pannell, Williams & Whitehead (2023) 3. The authors note that the FCA employs a more restrictive definition of 'prisoners' and that under its definition there were some 47,000 prisoners as of June 2021.
[111] Scanlon, Pannell, Williams & Whitehead (2023) 2-3.
[112] Scanlon, Pannell, Williams & Whitehead (2023) 5.
[113] FCA, *Mortgage Prisoners Review* (2021) para. 6.17.

this low impact reflected lenders' limited appetite to offer such products to borrowers that do not meet lenders' credit risk appetites.[114]

Borrowers trapped on high interest rate mortgages often suffer consumer harm. Although the Consumer Duty applies to mortgage prisoners', it appears to offer little meaningful value to them. The TPAs which manage the loans are 'regulated entities' and licensed by the FCA.[115] As such, their operations must comply with FCA regulation, and they are bound by the Consumer Duty.[116] While they are required to appreciate the difficulties facing consumers and work to support consumers to get a good outcome, TPAs are not active lenders and do not offer cheaper fixed rate loans. As such, they can claim their role is limited to supporting borrowers to switch to another lender, but switching is often impossible given that there are no better deals available.

In administering the loans, the TPA must comply with the Consumer Duty and the cross-cutting rules to act in good faith, avoid foreseeable harm and enable and support borrowers to pursue their financial objectives. This is particularly relevant where the borrower is vulnerable and/or is in repayment difficulties. However, as noted earlier, should a regulated provider, including a TPA, fail to adhere to these standards, the borrower has limited redress beyond a complaint to the FOS.

In summary, the Consumer Duty appears to do little to address one of the major contemporary instances of consumer harm in the mortgage market. The duty does not address the regulatory lacuna that enables vulture funds to exploit mortgage prisoners by keeping them locked into high SVR mortgages. Accordingly, further regulatory intervention is needed to address this scandal.

V Conclusion

The Consumer Duty expands the FCA's regulatory focus from ensuring firms have a 'good' process for conducting their business to also requiring that firms demonstrate they are delivering 'good' consumer outcomes. This shift from 'process' to 'process' and 'outcomes' is a significant conceptual and regulatory change. Following the ethos of principles-based regulation, the duty operates as a higher-level regulatory principle, although supported by detailed FCA guidance, which makes clear that the onus is on firms, particularly their senior managers, to mainstream the duty throughout their business processes and demonstrate that they are delivering good consumer outcomes. Thus, the duty creates more points for the FCA to review business practices and to take enforcement action. The duty also provides a hook upon

[114] FCA, *Mortgage Prisoners Review* (2021) para. 6.17.

[115] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020) 2.

[116] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020) 2, the authors note at page 2 that 'the setting of standard variable interest rates, a major concern for prisoners, is not a regulated activity'.

which the FCA can initiate regulatory probes into financial products or areas that expose consumers to heightened risk. The Consumer Duty will also support the FOS's work both in addressing consumer complaints and in raising their concerns about firms' harmful products and practices with the FCA.

The content of the Consumer Duty, from its fundamental principle through to the cross-cutting rules and outcomes, is laudable but largely builds upon existing approaches and understandings deployed by the FCA. Nevertheless, there are some interesting and potentially significant aspects. There is a greater focus on the individual borrower rather than borrowers generically. Lenders are expected to appreciate the mortgage transaction from the borrower's perspective. Coupled with this shift in focus are calls for mortgage providers and their advisers to understand a borrower's potential vulnerability and behavioural biases. These influences on borrowers' decision making are now better understood, with FCA research, for instance, revealing that borrower vulnerability is widespread.

The Consumer Duty recalibrates the set of factors that the FCA is to have regard to in determining what consumer protection is appropriate in the regulation of financial services. It enhances consumer protection standards by providing a counterweight to the highly contested consumer responsibility principle. In doing so, the duty reflects a tacit acceptance of the limitations of the neoliberal assumptions of rational decision-making that have underpinned financial services market regulation. Thus, it may be thought of in the same terms as the MMR and the MCD in effectively shifting additional responsibility for borrowers' harm onto mortgage providers. The more difficult question is how far that responsibility has shifted in practice. While there is potential for a significant shift, only time will tell.

Although consumer rights advocates can claim some success in winning the argument for reform, the nature of the Consumer Duty is quite different from consumer groups' initial proposals. It is not a fiduciary or statutory duty and it does not provide consumers with any additional remedies, such as an individual right of action against firms, or a process that enables courts to open up prejudicial mortgage terms/transactions.[117] Thus, the impact of the duty will depend on the FCA's monitoring and enforcement policy.

Both the potential, and limitations, of the Consumer Duty are particularly apparent in the case of consumer mortgages. Perhaps its greatest potential to address consumer harms is with equity release products. This market sector has been plagued by widespread and persistent poor business practices including the provision of unsuitable generic advice and the use of misleading promotions. Already there are signs that the FCA will look to the Consumer Duty to press providers and their

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[117] FCA, *A new Consumer duty, Feedback to CP21/13 and further consultation, Consultation Paper CP 21/36* (2021), paras 12.12-12.21.

advisers to mend their ways and demonstrate that their products are best suited to their consumer's individual circumstances and other adequate options have been considered.
The limitations of the duty are most clearly apparent in relation to interest-only mortgage products and the related mortgage prisoners' scandal. The Consumer Duty does not address the past regulatory lacunae which enabled the mis-selling of interest-only mortgages and vulture funds to exploit mortgage prisoners locked into higher SVR by keeping them in separate but authorised subsidiaries. The crux of these problems lies in the linear nature of the Consumer Duty, which looks to regulate the individual borrower-lender relationship. It cannot force, or even persuade, other mortgage providers to offer more suitable products to enable these trapped borrowers to switch to a better deal.[118] Recent changes to MCOB 13, which expand the range of forbearance options to include the waiving of principal and/or interest could hold more potential. However, these options lie within the lender's discretion and greater regulatory pressure may be required to 'persuade' lenders to do so. However, such pressure may not be forthcoming given the FCA has made clear that these forbearance rules do 'not impose on a firm's right to repossess the property providing all reasonable attempts to resolve the position have failed'.[119]

The mortgage prisoners' scandal starkly demonstrates the limitations of using principles-based regulatory measures to address pernicious forms of consumer harm. The scandal serves as a reminder that state intervention, involving primary legislation to expand effective remedies for consumers, may be the only way to address some instances of consumer harm.[120]

Ultimately, the Consumer Duty is just one facet of the mortgage regulatory framework and so its impact is inherently limited. The responsibility balance depends on a wider network of factors beyond the bargaining position of the parties. These factors include international economic and monetary conditions and developments in the national housing market. A change in an individual borrower's ability to meet repayment commitments can often arise from events that, although objectively foreseeable, are beyond their control. The cause of these events may also be beyond the control of their lenders.[121] A variation in mortgage terms, most significantly the interest rate charged, is the exception. Yet the Consumer Duty accepts the UK market conditions that can drive frequent fluctuations and differential in interest rates.[122] What the Consumer Duty, coupled with forbearance changes is the lenders' reaction to events

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[118] See the Parliamentary debate on the matter at https://hansard.parliament.uk/commons/2023-06-28/debates/EEAC8F5C-6A55-41DC-A455-0BC0B8CF73C6/MortgagePrisoners
[119] See PS24/2, at para. 2.34, available at https://www.fca.org.uk/publication/policy/ps24-2.pdf
[120] Scanlon, Pannell, Williams, Longbottom & Whitehead (2020); Scanlon, Pannell, Williams & Whitehead (2023).
[121] FG22/5, para. 5.36.
[122] FG22/5, para. 7.52.

that challenge the borrower's ability to pay, and calls for a more empathetic and individualistic reaction that can only be welcomed.

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PART II

COUNTRY REPORTS

CHAPTER I

SOME THOUGHTS ON THE BELGIAN RESPONSE TO THE MCD: UNIFORMISATION OF RULES ON CREDIT TO CONSUMERS

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I Introduction

When writing this article ten years have passed since the adoption of the MCD in Europe. No better time to reflect on its implementation in the Member States than now.[1] Those ten years allow us to review not only the letter of the law (*law-in-the-books*), but also its application in practice (*law-in-practice*). It must be said, though, that the number of published court cases in Belgium in the past ten years is very scarce (to non-existing). This does not mean that no complaints were filed nor that no judgments were pronounced. They are simply not published —by lack of (research) interest? The reflections on the applicable legislation in this article thus stems from my own personal experiences as an attorney and as a member of an advisory council to the Belgian financial ombudsman (although also in the latter case, the number of expert memoranda on the rules on Belgian mortgage credit law is scarce), as well as what one could pick up from informal discussions with members of the Belgian retail credit sector and of the Federal Public Service (FPS) Economy, one of the competent Belgian supervising authorities.

At the time when the MCD was implemented in Book VII, Title 4, Chapter 2 of the Code of Economic Law (CEL), the Belgian legislator seized the opportunity to uniformize the rules on credit agreements granted to consumers. The Belgian rules on consumer credit were already one of the strictest in Europe, and the Belgian legislator copy-pasted these precontractual information duties, including duties to advise the consumer on the most suitable credit agreement[2] and to abstain from granting credit when the consumer is registered in the negative hatch of the public credit register, to mortgage credit agreements.[3] Very recently (spring 2024), stricter rules on tying and bundling practices for mortgage credit agreements were adopted by Parliament.

Almost all violations of substantive duties imposed on creditors and credit intermediaries can be sanctioned through (i) private remedies (e.g. avoidance of the credit agreement, exemption to pay interest, damages; and sometimes when the court can qualify the violation also as an unfair commercial practice, it is possible that, given certain conditions, the consumer is fully exempted from repaying the amount of credit);[4] (ii) administrative fines (including the withdrawal of the license to grant credit or the registration as a credit intermediary,[5] monetary fines of maximum EUR 800,000.00 or 6% of the total annual turnover, if the latter would lead to a higher fine);[6] and (iii) criminal sanctions (including imprisonment and criminal fines of

[1] See on the implementation of the MCD in Belgium: Verheye & Sagaert (2017) 113-163.

[2] For its conformity with the CCD 2008, see ECJ 6 June 2019, *Michel Schyns* v. *Belfius Banque SA,* C-58/18, EU:C:2019:467.

[3] For its scope *ratione materiae*, see below section II.2.

[4] Art. VI.38 CEL.

[5] Art. XV.67 – XV.68 CEL.

[6] Art. XV.60/20, § 1 *juncto* Art. XV.70, § 1, 5 CEL.

maximum EUR 800,000.00 or 6% of the total annual turnover, if the latter would lead to a higher fine).[7] More than the fear of encountering reputational risks, creditors are particularly careful due to the possible administrative (in particular, the loss of the license to trade in credit agreements) and criminal sanctions.

In the past, specific tax stimuli drove the Belgian residential property, and mortgage credit market. Under certain conditions consumers could claim tax deductions for their mortgage credit, used to finance their residential dwelling. Due to policy changes and budget cuts, the tax deductions for mortgage credit agreements are already abolished in the Brussels and Flemish Region. In 2025 the Walloon Region will also cancel the tax deductions for newly concluded mortgage credit agreements.

II Scope of Application

Credit agreements granted to consumers fall under the scope of Book VII, Title 4, Chapter 1 or 2 CEL. The first chapter contains the rules applicable to consumer credit agreements (implementing the rules of the CCD 2008) and Chapter 2 contains rules on mortgage credit agreements (implementing the rules of the MCD). Mortgage credit agreements are seen as the most specific type of credit agreement, meaning that when a credit agreement to a consumer cannot be considered as a mortgage credit agreement, the agreement will fall under the scope of the (residual) category of consumer credit agreements (Book VII, Title 4, Chapter 1 CEL).[8]

1 Personal Scope of Application

This section does not aim to give an exhaustive overview of the personal scope of application of the Belgian legislation on credit agreements granted to consumers. It will merely highlight some peculiarities concerning the Belgian personal scope of application of the rules on residential / mortgage credit.

1.1 Creditors

In Belgium, most mortgage credit agreements are offered by credit institutions.

There is a small but increasing number (+/- 11%) of non-credit institutions, like insurance companies, other creditors (currently only 6 out of 101 Belgian mortgage lenders), social creditors (Art. VII.3, § 4, 2° CEL), etc. who also offer mortgage credit agreements.[9] Within this group, the insurance companies offer specific types of

[7] Art. XV.86/1 – XV.91 CEL *juncto* Art. XV.70, § 1, 5 CEL.

[8] Art. I.9, 54° CEL.

mortgage credit agreements, called reconstitution loans ('wedersamenstellingskrediet')[10] and/or advance payments on a life-insurance policy ('voorschot op polis').[11]

Currently, there are no foreign creditors holding a Belgian mortgage credit licence. There are nine foreign creditors who are registered in Belgium to offer mortage credit agreements based on the freedom to provide services in the EU. There are also sixteen foreign creditors who are registered in Belgium to offer mortage credit agreements via a branch.[12]

In Belgium, there is only one crowdlending platform who was granted a license as a creditor (a company named 'Mozzeno'). It only offers consumer credit agreements, including renovation loans (see below, II.2.) and B2B-credit agreements. In the mortgage credit market, there are no crowdlending platforms active in Belgium.

1.2 Comparison Platforms are Considered as Credit Intermediaries

A limited number of comparison platforms are active in Belgium, mainly in the consumer credit market. The main reason behind the low number of active platforms lies in the broadly defined notion of credit intermediation. Art. I.9, 94 CEL defines it as follows:

> 'The activity that consists of the following acts:
>
> a) Proposing or offering credit agreements to consumers; or
> b) Assisting consumers, other than referred to in a), in the preparation of concluding a credit agreement; or
> c) Concluding credit agreements with consumers, either on behalf of a creditor or on its own account if this activity is carried out by a creditor who does not use a credit intermediary.'

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[9] FSMA, Register of mortgage creditors, https://www.fsma.be/nl/kredietgevers; Report from the Commission to the European Parliament and Council on the review of Directive 2014/17/EU (2021), COM(2021) 229 final, 12-14.

[10] Art. VII.135 - VII.136 CEL. Reconstitution loans are loans whereby the capital is reconstituted by means of an annexed contract, the latter being a life insurance agreement, a capitalization agreement ('kapitalisatiecontract') or another type of savings' agreement.

[11] Art. 180 Belgian Insurance Act of 4 April 2014. An advance payment on a life-insurance policy is a contract which grants an individual right to the policy holder (in case of an individual life insurance) or an employee (in case of a group insurance) to receive a partial advance based on the current value of the policy before the end of the insurance contract upon payment of interest. See D'Haen & Heymans (2009) 22.

[12] FSMA, Register of mortgage creditors. See https://www.fsma.be/nl/kredietgevers.

The above-mentioned tasks are not cumulative to be considered an activity of credit intermediation. Accordingly, for instance the promotion of (the conclusion of) credit agreements via advertisements or the act of comparing interest rates offered by different creditors and sorting them for the consumer are considered acts of credit intermediation.[13] Consequently, the platform comparing interest rates requires a registration as a credit intermediary and needs to fulfil all regulatory requirements. Losing a lot of easy profit, due to the risks and compliance involved as a credit intermediary, many (platform-)players do not deem it fit to register as a credit intermediary purely to compare interest rates. Reflecting on it from the consumer's point-of-view, it certainly brings extra protection that pure commercial platforms shall need to comply with the same regulatory requirements (and risking the same criminal and administrative sanctions in case of a breach) as a traditional credit broker. It creates a level playing field amongst credit intermediaries and lowers the risk of pure profit-seeking commercial platforms entering the credit market without any product-knowledge.

1.3 Commercial Lead Generators

Creditors and credit intermediaries are regulated persons. They must meet certain regulatory requirements.

Although not formally recognised by law, the Belgian competent supervisory authority, the Financial Services and Markets Authority (FSMA), tolerates that certain market actors can play a well-defined role in a credit transaction without being required to register as a credit intermediary or obtain a licence as a creditor. These actors' core business does neither entail activities of credit intermediation nor granting credit transactions; their main business purpose is to sell products and services the acquisition of which can be financed through a credit agreement. In the context of this article, these include construction firms, builders, real estate brokers, etc. who hope to close their deal with the consumer more easily if they can refer the client to a creditor or credit intermediary. These are called commercial lead generators, because they sign a partnership agreement[14] with a licensed creditor or a registered credit intermediary.

Their sole role is to refer or introduce potential customers to a credit intermediary or to a creditor, without acting as a credit intermediary themselves. Accordingly, the commercial lead generator may not carry out activities that are reserved for credit

[13] Davidts & Caulier (2017) 121; Steennot (2016) 73.

[14] However, they are neither allowed to be bound by a commercial agency agreement nor to have received the authority to represent their lead partner to the consumer. See FSMA, FAQ 175. What is a commercial lead generator for credit agreements (2024).

intermediaries (see above, I.2). It may occasionally introduce or refer a consumer to a creditor or credit intermediary during its professional activity; for example, by drawing the client's attention to the existence of a particular creditor or credit intermediary.

This also means that commercial lead generators may not carry out any further advertising activities nor engage in the presentation, offering, preparation or conclusion of the credit agreement. The commercial lead generator may only transmit to the consumer non-personalized information prepared by the creditor or credit intermediary.[15]

Furthermore, the commercial lead generator may not be paid (by the creditor or the credit intermediary) depending on the duration and/or the number of financial services the consumer in the end buys from the creditor or through the credit intermediary.[16]

2 Material Scope of Application

It seems that in Belgium no foreign currency loans are granted. Creditors felt it too burdensome and too legally uncertain to comply with the required information and substantive duties. Hence, I will not further discuss this type of credit agreement in this article.

There are also no equity release agreements. There were already two attempts to introduce a reverse mortgage credit in Belgium. The financial sector is not interested in the product, though. Also, from a legal point of view a lot of hurdles relating to property law, family law and tax law need to be taken into account, due to which also the political climate lacks interest in the product.

This subsection focuses on the notion of mortgage credit agreements, as well as on green loans (meaning credit agreements to finance renovation works and/or the acquisition and installation of green energy systems, such as solar panels, etc.).

2.1 The Notion of Mortgage Credit Agreements

One of the most important novelties after the MCD was implemented was the broadened material scope of application of the rules on mortgage credit.

[15] FSMA, FAQ 175. What is a commercial lead generator for credit agreements (2024).

[16] FSMA, FAQ 175. What is a commercial lead generator for credit agreements (2024).

Under the old mortgage credit act of 1992, a mortgage credit agreement was a credit agreement (i) secured by a mortgage, and (ii) where the amount of credit was used to acquire or retain immovable property. Both conditions were cumulative.

Since the implementation of the MCD, Book VII CEL differentiates between mortgage credit agreements for movable purposes ('hypothecair krediet met roerende bestemming')[17] and mortgage credit agreements for immovable purposes ('hypothecair krediet met onroerende bestemming').[18]

The first subcategory of mortgage credit agreements consists of credit agreements (i) secured by a mortgage (ii) where the amount of credit is used to acquire or retain movable goods. Before the MCD, this kind of credit agreement was categorised as a consumer credit agreement, since it failed to meet the above cumulative conditions to qualify as a mortgage credit agreement under the old Act of 1992. Notwithstanding the new label since the implementation of the MCD, this kind of credit agreement is still mainly treated in the same way as a consumer credit agreement with regards to rules on maximum interest rate caps, defaults and enforcement upon default, for instance. Because the aim of these credit agreements is to acquire movable property, they will not be discussed further in this section.

The second subcategory of mortgage credit agreements is –on its turn– composed of three subcategories of mortgage credit agreements, namely: a) credit agreements secured by a mortgage where the credit is used to acquire or retain immovable property (again, both conditions must be fulfilled cumulatively); b) credit agreements not secured by a mortgage but where the credit is used to acquire or retain immovable property, except for credit agreements used to finance renovation projects, because renovation loans are still categorised as consumer credit agreements[19] (see below II.2); c) (un)secured credit agreements to acquire or retain property rights on a ship. This is very surprising, because a ship is a movable good. However, Belgian law recognizes the concept of ship mortgages. Given its high (acquisition and/or security) value, ship mortgages are assimilated to mortgages (on immovable property; see below II.3).[20]

[17] Art. I.9, 53/2° CEL.

[18] Art. I.9, 53/1° CEL.

[19] Art. 46 MCD; Art. 2a CCD 2008.

[20] Casier, Heymans & Vannerom (2019) 76-95.

2.2 Renovation and Green Loans

Currently, a lot of green loans are being promoted with interest rate reductions. Creditors try to profit from certain renovation waves, especially in the green energy sector, which are stimulated by the Belgian and regional governments. In certain cases, new house owners are even obliged to renovate within a certain number of years after the acquisition of their house. Most of these loans –although intended for immovable purposes– are not secured by a mortgage because the amount of credit is still relatively low, and the duration is relatively short. Notwithstanding the immovable purpose, *almost* all green loans are qualified as renovation loans and thus considered consumer credit agreements.

The notion of renovation was not defined by Book VII CEL. In the parliamentary works the following definition can be found:

> 'The adaptation of a house or appartement to the current requirements of basic living standards and therefore it can include all kinds of construction works. All works relating to immovable property can be taken in scope: both major renovation works (changes to the structure, extension of the house, etc.), as well as works that concern part of the house, such as roofing works, insulation works, electricity renewal, replacement of windows and doors, renewing central heating, renovating a kitchen or bathroom, renovating a staircase, renovating the floors, painting, wallpapering, landscaping the garden, renewing fencing, etc.'[21]

Furthermore, considering the material scope of application of the CCD (2008 and 2023) and the MCD, rental agreements and other types of service agreements are often excluded from their scope. As such, the law on credit agreements to consumers cannot fully keep up with the rapid changing sharing economy and servitisation of our society. Whilst in the past the consumer bought goods, these are now being shared by numerous consumers. Furthermore, consumers often no longer invest in the acquisition of certain goods, like solar panels, heat pumps, etc. These products are offered to them as services by commercial companies who do not transfer ownership of these goods to the consumers, but instead provide the goods as a service to the consumer. Because the consumer only has usership rights over the goods and does not buy them, a continued service agreement with periodic payments –resembling the traditional instalment loans– falls outside the scope of application of the CCD 2008 and MCD.[22] Indeed, when the agreement for the installation of the solar panels does not entail a transfer of ownership (for instance, it is packed as a kind of rental agreement for the use of the solar panels) nor does it contain a purchase option

[21] Parliamentary Proceedings, *Parl. St.* Belgian Federal Parliament (2015-2016) 9.

[22] Only lease agreements with a purchase option fall under the CCD 2008 (see Art. 2 (2)(d) CCD). The same occurs in the CCD 2023. See Arroyo (2024) 5-6.

provided in the rental agreement or in another agreement, then the agreement is not a credit agreement and the strict consumer protection rules of Book VII CEL do not apply to it, leaving the consumer with less protection notwithstanding the fact that – economically speaking – he or she is bound to a similar kind of payment obligation.[23]

3 The Mortgage and Other Security Rights

3.1 The Notion of a Mortgage

To allow a better understanding of the Belgian mortgage credit market, it is necessary to briefly introduce the notion of the legal mortgage under Belgian law as well as some peculiarities in Belgian mortgage law which are of importance for creditors offering mortgage credit agreements.

Under Belgian law parties cannot –simply by way of contract– introduce new types of security rights. Moreover, also the concept of a mortgage cannot be altered by the contractual freedom of the creditor and the consumer. The only variations to the mortgage configuration allowed are those established by the Belgian Mortgage Act of 16 December 1851 (Hyp.W).

Nonetheless, the mortgage (on a certain good) must be established by a notarial deed, which is required for the registration of the mortgage in the public, official mortgage register.

Under Belgian law, a mortgage is a real security right. The mortgagor – here, the consumer or a third party – gives a security right over an identifiable, immovable good (and ships) (see below in this section) ('hypotheek') to the creditor (the mortgagee). Contrary to English law, there is thus no transfer of ownership of the mortgaged good to the mortgagee. Inherently, under Belgian law the creditor obtains a security right which follows the immovable property when sold ('volgrecht') if the underlying debt is not fully repaid and/or the mortgage is not released ('handlichting'). The mortgagee has a legal preferential right[24] on the mortgaged good. The mortgagee does not entail an immediate foreclosure right ('recht van parate executie'). The mortgagee must start enforcement proceedings before the attachment judge to foreclose the mortgaged good.[25]

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[23] Art. I.9, 39° CEL.

[24] Art. 9 Hyp. W.

[25] Jansen & Muylle (2019) 16-17.

Mortgages have a maximum term of thirty years, except if the registration is renewed before the end of the term.[26] If the mortgagor, with the agreement of the mortgagee, has paid the mortgage loan early, the mortgagor must request the release of the mortgage and pay the costs thereof. This is why some mortgagors do not request the release of the mortgage despite having repaid the loan, knowing the mortgage will expire *ex officio* after the end of the current 30 years' term.

As already mentioned, in principle mortgages must be vested on immovable property. They can be created, though, on buildings which are still being constructed or even which are just being designed by the architect upon the condition that the mortgagor has a building licence.[27] Mortgages can also be established on the mortgagor's co-ownership share of an immovable property. Mortgages cannot be established on movable goods in Belgium, except for ships. Neither can a mortgage be created on property belonging to someone else[28] (hence the recurring practice in the Belgian mortgage credit sector to demand a third-party mortgage; for instance, the parents' house may serve as security for the repayment of the loan taken by one of the children) nor on future immovable goods (except for buildings being constructed or designed, as already mentioned).

The Belgian Mortgage Act allows secured creditors to stipulate a mortgage 'for all sums'[29] ('alle sommen hypotheek'), whereby the mortgage –often holding the first rank at the register– will cover all current and future debts of the consumer(s) vis-à-vis the secured creditor. It can be problematic when this type of mortgage is created in favour of a particular creditor by a third party (for instance, by the parents) for all current and future debts of the debtor.[30] Therefore, since 2018 a discussion among legal scholars arose with regards to the interpretation of article VII.147/26, § 1 *in fine* CEL. According to this article the creditor must provide in advance and free of charge the mortgagor with a copy of the credit agreement. Some authors argue that, based on a literal interpretation of this provision, it is impossible to affix new credit debts to an existing mortgage for all sums granted by third party mortgagors. According to their views, the creditor cannot comply with this provision –more precisely, provide a copy of the credit agreement before the mortgage is created– because the mortgage already encumbered the asset and the new debt only came into existence after the registration

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[26] Art. 90 Hyp. W.

[27] Art. 45*bis* Hyp. W.

[28] Art. 73 Hyp. W.

[29] Parliamentary Proceedings, *Parl. St.* Belgian Federal Parliament (2015-2016) 53; Joisten (2017) 349; Sagaert & Swinnen (2010) 682-684.

[30] Joisten (2017) 381-387. See also BRC Onrechtmatige Bedingen (2018) recommendations 8 and 9.

of the mortgage in the public mortgage register.[31] Other authors disagree. According to these, the article purely installs information duties to protect third party mortgagors against new debts secured by their mortgage of which they would not be aware of. They must know –and thus be informed– about the maximum (amount of) debt for which their property serves as security. When the mortgage for all sums is established, the maximum amount of the secured debt (which can be a different amount than the amount of credit)[32] is mentioned in the mortgage deed. As such, at least the *ratio legis* of article VII.147/26, § 1 *in fine* CEL –namely, the duty to inform third party mortgagors– is respected.[33]

3.2 Other Comparable Security Rights

Apart from the mortgage, other comparable security rights on immovable property can lead to a qualification as a mortgage credit agreement. In Belgium, it is common practice to make use of two other comparable –and derived– security rights.

A mortgage proxy ('hypothecaire volmacht') is a right conferred to a mortgagee to create a mortgage on the designated immovable property. The mortgagee has the right to establish the mortgage at its own discretion, meaning that renewed consent from the owner (the mortgagor) is not required. The mortgagor's consent to create a mortgage (in the future) over that immovable was given at the time the mortgage proxy was concluded. This requires the mortgage proxy to be in the same form as the future mortgage, meaning that a mortgage proxy must be concluded through a notarial deed.[34]

A mortgage promise ('hypotheekbelofte') is a unilateral, private contract (not concluded by means of a notarial deed), according to which the promisor merely promises to grant a mortgage in the future at the request of the other party.[35] Hence, the promisee still requires actions and consent of the promisor to create the mortgage. Furthermore, a court does not have the power to coerce a party who merely gave a mortgage promise to actually sign a mortgage deed.[36] A mortgage promise comes at low cost or even free of charge for the promisor, but at high risk of the promisee.[37] In

[31] Biquet-Mathieu (2016) 403; de Patoul & Schoonheyt (2017) 327.

[32] Joisten (2017) 350.

[33] Casier, Heymans & Vannerom (2019) 517-520; Cattaruzza & Vandenbroucke (2017) 227.

[34] Art. 76 Hyp. W.

[35] Wynant & Grootjans (2019) 58.

[36] Jansen & Muylle (2019) 19.

[37] Wynant & Grootjans (2019) 59.

practice, a mortgage promise will only be accepted by a creditor when this creditor already has another (real or personal) security right over the debtor's movable and/or immovable property.

III Pre-Contractual Duties

1 Advertising

Any advertising which contains an interest rate or any figures relating to the cost of the credit must include standard information. The standard information is explained to the consumer via a representative example. The representative example is based on the average amount of credit and average duration of mortgage credit agreements granted (in case of a creditor) or proposed (in case of a credit intermediary) by the advertiser.[38]

Book VII, Title 4, Chapter 2 CEL also has a blacklist of certain advertising messages which are forbidden. For instance, no one is allowed to advertise refinancing loans (the technique as such is not forbidden, but one is not allowed to advertise it), to target vulnerable consumers who are already indebted, to indicate in advertising that there is no creditworthiness analysis and/or that owing property is sufficient to obtain a mortgage credit, etc.[39]

On top of these specific advertising provisions in Book VII CEL, creditors and credit intermediaries must comply with the general rules of common consumer contract law, especially those on unfair commercial practices.[40] The MCD did not harmonise exhaustively the advertising rules for mortgage credit agreements. The Belgian rules implementing the Unfair Commercial Practices Directive and more recently the Empowering Consumers Directive 2024/825 are of relevance in the context of respectively tying and bundling practices, and green loans (and greenwashing).

2 Tying and Bundling Practices

In accordance with the MCD tying practices are forbidden in Belgium.[41] Bundling practices are allowed under certain conditions. The consumer must always have the free choice to pick a service provider. Furthermore, in case of interest-rate reductions –very common in the Belgian context of mortgage credit agreements– the creditor is

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[38] Art. VII.124 CEL.

[39] Art. VII.123, § 2 CEL.

[40] Art. 11 (7) MCD.

[41] Art. VII.147, § 1 CEL.

only allowed to withdraw the reductions under some very strict conditions. These rules were even made stricter in spring 2024.[42]

The conditional reduction on the cost of credit, and/or of the interest rate is only permitted for some insurance products (most commonly a fire insurance and/or a payment protection insurance (PPI)) and/or for opening/holding a payment account.

The conditional reduction is offered separately per bundled product type and must be mentioned separately (the reduction must be mentioned explicitly) per bundled product type.

In the context of a conditional reduction, the creditor is obliged to maintain the reduced rate of the credit agreement without additional costs if the consumer exercises the right to switch to a service provider of his or her choice: a) after the first third of the term of the credit agreement, or b) for the first third of the term of the credit agreement, if during that period: the insurer applies an increase of the cost (the ABEX index[43] to the insured value does not constitute a rate increase); or the insurance has been cancelled after a claim has arisen; or the consumer terminates the framework contract of the payment account, which is part of the bundled sale giving rise to a conditional reduction, in the context of a payment account switching service as provided for in Book VII, Title 3, Chapter 9/1 CEL.

The credit agreement must indicate from what moment exactly the consumer can change the service provider of each bundled product without losing the conditional cost reduction. During the credit agreement, the creditor is also obliged to inform the consumer of the exact date of the first third of the term of the credit agreement referred to above upon the consumer's simple request.

3 Standard Information Duties (Prospectus)

The creditor or, where applicable, the credit intermediary must make available, at any time and free of charge, standard information on paper, on another durable medium or in electronic form to the consumer. In Belgium this document is referred to as the prospectus.[44]

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[42] Art. VII.147, § 1/1 CEL.

[43] The ABEX Index registers the evolution over time of the cost price for building a dwelling in Belgium.

[44] Art. VII.125 CEL.

4 The ESIS

In addition to the obligation to provide standard information to the consumer, a creditor and where applicable, a credit intermediary must give personalized information to the consumer. The information is intended to enable the consumer to compare the credit products available on the market, to assess their impact on the borrower's (financial) situation and to take an informed decision on the conclusion of the credit agreement.[45] This personalized information is provided by means of the ESIS on paper or on another durable medium. The creditor or the credit intermediary shall provide the ESIS in due time before the consumer is bound by a credit agreement. The notion of due time is not defined in Belgian law and can thus be reduced to a couple of seconds before printing the mortgage credit agreement. However, at first glance the lack of a clear (nationally) defined notion of 'due time' seems to be more problematic in the context of consumer credit agreements where the credit is applied for and granted at a much quicker pace than when seeking a credit agreement to finance the acquisition of a house or appartement. However, larger sums are involved in the context of mortgage credit agreements, and the impact on the consumer is bigger since the immovable property is mortgaged. It is recommendable to provide some (national) guidelines in the future, as for instance it is now foreseen for consumer credit agreements.[46]

For each (renewed) demand for a mortgage credit agreement, an ESIS must be provided. Furthermore, if more than one advance under a framework mortgage credit agreement is granted to the consumer (each with distinctive credit conditions) an ESIS must be provided for each advance.[47]

Together with another author I raised some criticism towards the use of the APRC in the ESIS and its utopian image that it allows consumers to make a well-informed choice. According to us, the APRC can even (be used) to mislead the consumer.

Indeed, the APRC can provide a useful and additional comparison parameter for the consumer, which is, however, not the only parameter. The consumer must also consider the total amount of interest (and costs) to be paid, the repayment method and the duration of the proposed mortgage credit agreement to make a correct comparison and not to be misled by the offer with the lowest APRC.

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[45] Art. VII.127 CEL.

[46] Art. 10 (1) CCD 2023.

[47] Casier, Heymans & Vannerom (2019) 517-520; Cattaruzza & Vandenbroucke (2017) 227.

For example, an interest-only credit agreement[48] appears to be cheaper if one only looks at the APRC. Based on the total amount of interest to be paid, the interest-only credit agreement is a lot more expensive. With an interest-only credit agreement, the monthly payment during the credit agreement is lower than a classic mortgage credit agreement with instalments covering both interest payments and a repayment of the principal amount. The consumer must furthermore consider the obligation to repay the principal at once at the final maturity date.

A mortgage credit agreement with monthly installments over 30 years and the usual 'upfront' costs has a lower APRC than the same kind of credit agreement over 25 years. However, the 25-year credit agreement is cheaper if the total amount of interest is taken as a basis for comparison.

The above examples make it clear that the repayment method and the duration of a mortgage credit agreement are equally important factors as the interest rate when comparing credit offers. If the consumer is informed of the APRC without any further explanation regarding the repayment methods and the impact of the duration of the credit agreement on his or her financial situation, the consumer – though informed in accordance with the personalised information duties as foreseen by the MCD – might still make an inadequate decision as to the offered credit agreement. It is recommendable that more attention (e.g. in the context of personalised advice duties) is paid to factors other than the APRC when proposing credit to consumers. As well as the repayment method and the duration of a mortgage credit agreement, there are more factors that impact the consumer (e.g. the time of payment of the costs and interest, the rounding off rules, the impact of an insurance premium in the context of a bundled sale on the calculation of the APRC, etc). The effects of the different parameters and factors can compensate or reinforce each other.[49] Therefore a sole focus on the APRC is not enough to adequately protect consumers.

Hence, it is good to combine the ESIS with a more pronounced advice duty, like we know it in Belgium.

5 Duty to Give Personalised Advice

In fact, and on top of the duty to give adequate explanations,[50] a creditor and/or a credit intermediary must indicate to the consumer what the most suitable type of

[48] Although no public statistical data is available, it appears that the number of interest-only mortgage credit agreements granted in practice is still relatively low.

[49] Vannerom & Casier (2015) 257-294.

[50] Art. VII.129 CEL.

credit agreement is, considering the consumer's preferences, the amount of credit, the purpose for which credit is sought and the desired duration of the credit.[51]

The advice is free of charge for the consumer. The advice is seen as an inherent part of the information duties imposed on creditors and credit intermediaries and their role in the credit granting process. Only creditors or a credit intermediaries are allowed to provide advice on mortgage credit agreements to consumers.

6 A Written Offer

The consumer receives a credit offer in writing. The offer is binding on the side of the creditor for at least fourteen days. However, the consumer is not bound by this term. The consumer may immediately accept the offer and as a result thereof the mortgage credit agreement is concluded.

IV Pre-Contractual Creditworthiness Assessment

The creditor must request information from the consumer on his or her financial situation. At least, information must be requested on the purpose of the credit, the consumer's income, the current financial charges (including the outstanding amount and the number of credit agreements currently ongoing) and the number of persons under his or her charge.[52]

The creditor must demand supporting documents, such as recent salary slips, tax declarations, etc.

Under no circumstances the information requested for obtaining the credit agreement may relate to race, ethnic origin, sexual behaviour, health, beliefs or political, philosophical or religious activities or membership of a trade union or health insurance fund.[53] This prohibition clearly wants to protect the consumer against discrimination for obtaining credit. The prohibition is proportional, because the consumer's race, ethnic origin, membership of health insurance funds, etc. do not impact his or her creditworthiness. The creditworthiness assessment is a micro-financial –meaning a personalised– assessment of the consumer' financial situation (his or her income and financial burden).[54] Hence, there is neither legitimate reason

[51] Art. VII.131 CEL.

[52] Art. VII.126 CEL.

[53] Art. VII.126, § 1 CEL.

[54] See also art. 18 (3) CCD 2023 in the context of consumer credit agreements.

nor a legal ground –not even when the consumer would consent– for creditors to demand this kind of information.[55]

Furthermore, the creditor must check the public credit register –the 'Centrale voor kredieten aan particulieren' (CKP)– held at the Belgian National Bank before granting a credit agreement. The creditor must abstain from granting credit when the consumer is reasonably not capable to repay the requested credit agreement. This means that the creditor must be extra careful and prudent before granting credit to a consumer who is registered in the negative hatch of the credit register and/or if a consumer requests a refinancing loan.

The creditor must conduct a thorough creditworthiness analysis.[56] It is a personal, individualised assessment of the creditworthiness based on the supporting evidence and documents provided by the consumer. An analysis purely based on statistical data is not allowed in Belgium.

It has been established for a long time –even for B2B loans– that no credit may be granted purely based on the (value of the) collateral.

V Right of Early Repayment

The right of early repayment is not disputed in Belgium.

Already before the transposition of the MCD, the consumer was entitled to the early repayment of the mortgage credit. The consumer always enjoys the right of full early repayment. It does not even need to be requested, i.e. the consumer can simply inform the creditor of the intention and repay the full outstanding amount.

The consumer also enjoys a right of partial repayment. This right of partial early repayment can be restricted. However, the consumer always enjoys the right to make a partial repayment once a year, and/or of an amount equal to at least 10% of the principal.[57]

In case of an early right the creditor is not allowed to claim his real losses. The funding loss is capped at a maximum amount equal to 3 months of interest.[58]

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[55] See also Art. 9 GDPR and Art. 19 (5) CCD 2023.

[56] Art. VII.133 CEL.

[57] Art. VII.147/11, § 1 CEL.

[58] Art. VII.147/12, § 1 CEL.

VI Greening the Belgian Property Market

The Belgian financial sector committed itself to support initiatives to green the Belgian property market, for instance by granting interest rate reductions for consumers who use the loan agreement to make their dwelling more energy efficient.[59] The reduction –for the duration of the credit agreement– is granted upon the receipt of an improved EPC-label (compared to the EPC-label issued at the time of conclusion of the credit agreement). Of course, the Belgian financial sector has its own interest in promoting greening the retail market. Prudential requirements oblige creditors to monitor closely the value of their collateral.[60] Energy insufficient dwellings will –given the current political policy initiatives against the climate change– decrease in value. The Belgian financial sector also feels the pressure of the Belgian government appealing to private professional actors to play their role in the energy transition.

Also, consumers feel the government's pressure to green the Belgian property market. Since 2023, the Flemish Region imposed renovation duties for consumers who bought or otherwise –e.g. through inheritance, donation, etc.– acquired a dwelling or obtained a superficiary or emphyteutic right relating to a dwelling –be it a house or an appartement– with an EPC-label E or F. Within six years[61] after the acquisition of the dwelling the consumer must improve the dwelling to an EPC-label D or higher.

When the consumer includes the mandatory energy-saving renovations in the requested amount of credit, his credit worthiness will be adequately assessed (see above IV). However, if the consumer at first only requests a mortgage credit to acquire the ownership of the energy insufficient dwelling, the creditor –given the mandatory renovation duty– should (ideally) pay attention to the predictable higher financial burden for the consumer, for instance by including a statistical based lump sum as extra financial burden in the creditworthiness assessment. Indeed, in the near future this consumer will be required to use part of his or her income to pay for the required renovation works and/or pay a new renovation loan used to finance these works. According to article I.9, 84° CEL the creditworthiness assessment also requires creditors to consider the prospect income and financial burden of the consumer for the duration of the requested credit agreement.

[59] BVK (2023) 56-57.

[60] See for instance EBA (2020) 53.

[61] It is currently five years, but the new Flemish government extended the deadline to six years. See https://www.vlaanderen.be/een-huis-of-appartement-kopen/renovatieverplichting-voor-residentiele-gebouwen.

VII The Enforcement of a Defaulting Mortgage Credit Agreement

1 The Notion of 'Default'

As soon as the consumer does not make full payment of an instalment, he is in default. Costs, indemnities, and late payment interest are due on the amount overdue. For each not fully paid or unpaid instalment a ‘formal notice letter’ must be sent to the consumer within three months of the default.[62] If the creditor does not notify within this term, it can no longer claim the increased late payment interest for that particular payment default. Furthermore, the consumer enjoys a six-month deferral of payment for that payment default free of charge. This payment deferral takes effect from the lapsed due date.[63]

Being three months in arrears is an important threshold. Having reached this threshold, the creditor is obliged to register the default in the CKP. Furthermore, it allows the creditor to terminate the credit agreement for breach of contract.

Indeed, if the consumer is in arrears of at least two instalments or an amount equal to 20% of the total amount to be repaid, the creditor can send the consumer a formal notice letter by registered mail.[64] In this formal notice letter, the creditor must mention the amounts overdue, the costs, indemnities and late payment interest. The creditor must also warn the consumer, in this letter, about the consequences of default; and more precisely, that the credit agreement will be terminated one month after the formal notice letter is sent if the outstanding debt is not repaid.[65] It also needs to warn the consumer that the mortgage may be enforced on the property.

Finally, since the implementation of the MCD, Belgian mortgage credit law has strict rules on express termination clauses.[66] Unlike for consumer credit agreements, these were previously not regulated under mortgage credit law. Now, only a limitative list of express termination clauses is allowed.[67] Apart from this list, article VII.147/20, § 2 CEL includes several situations in which a mortgage credit agreement can only be terminated by a court order, thus restricting the discretionary power of a creditor to unilaterally terminate a mortgage credit agreement for immovable purposes.

[62] Art. VII.147/21 CEL.

[63] Art. VII.147/21, al. 2. CEL.

[64] Art. VII.147/20, § 1, 1° CEL.

[65] Art. VII.147/20, § 3, al. 1 CEL.

[66] Art. VII.147/20 CEL.

[67] Art. VII.147/20, § 1 CEL.

2 Late Payment Interest Rate Caps and Capped Costs

Since 2001, Belgian consumer credit law capped the amounts of costs and indemnities a creditor was allowed to claim in case of default in a consumer credit agreement. It is a *numerus clausus,* as only those costs and indemnities mentioned in the CEL can be claimed by the creditor. The same caps applied if the consumer credit agreement was secured by a mortgage. These rules still apply today for consumer credit agreements and mortgage credit agreements for movable purposes.

With the implementation of the MCD, the legal caps were also introduced for mortgage credit agreements for immovable purposes.[68] In the event of a default on mortgage credit agreements for immovable purposes, only the following (maximum) amounts and penalties can be claimed from the consumer:[69] a) the amount overdue (meaning the principal amount and contractual interest and costs overdue and not paid); b) the contractual late payment interest rate, if contractually foreseen (Art. VII.134, § 3, 7° CEL). The late payment interest rate is capped, though, to a maximum increase of 0.5% *per annum* in comparison to the interest rate of the loan;[70] c) the agreed costs for notice letters sent after the default has occurred. The costs are capped, though, to one notice letter per month. These costs consist of a maximum lump sum of EUR 7.50 plus the standard tariffs for registered mail applicable at that time.

If the mortgage credit agreement is terminated due to default, a funding loss can be claimed in addition to the above. In Belgium, the amount of the funding loss is determined as a lump sum and no actual damages must be proven. The lump-sum is capped at three months of interest, even if the creditor's actual loss is higher.[71]

3 Voluntary Forbearance

In theory, a consumer is always entitled to ask for deferred payment facilities. Either mutually agreed with the creditor or by court order (see below 4).

Although Belgian consumer credit law only forbids contract terms allowing a creditor to unilaterally modify the conditions of the credit agreement, one of the Belgian supervising authorities, the Federal Public Service (FPS) Economy, has given a very broad interpretation to this prohibition. Apart from some exceptions foreseen by law (e.g. on the variability of interest rates), the FPS Economy argues that a creditor and

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[68] Renson & Biquet-Mathieu (2017) 420-424.

[69] Art. VII.147/23 CEL.

[70] Art. VII.147/23, § 1 and § 2, 3° CEL.

[71] Art. VII.147/12, § 1 CEL.

a consumer cannot by mutual agreement modify the content of their consumer credit agreement during its course. If they do so, the FPS Economy qualifies the modified agreement as a new credit agreement requiring again a creditworthiness analysis (including of a consumer who is already in financial distress).[72] The same interpretation by the FPS Economy is upheld with regard to mutually agreed changes to a mortgage credit agreement for movable purposes.

Because it was a longstanding practice under the old Mortgage Credit Act of 1992 that creditors and consumers were allowed to change their existing contracts by mutual agreement, a political compromise was found at the time the MCD was implemented, to further allow mutually agreed modifications to running mortgage credit agreements for immovable purposes upon the condition that the request for financial arrangements is initiated by the consumer.[73] Not all credit conditions can be modified. There is an exhaustive list of possible changes in article VII.145 CEL. These include the reduction or prolongation of the term, the change of a debtor, the request for an additional surety or giving temporary relief to the consumer to reimburse the credit agreement. Surprisingly, the option to modify the amount of periodical instalments is not included in the list, although this also seems to be a useful and efficient way of giving some financial relief to the consumer. However, once again –and now even explicitly– the legislator obliges the creditor to perform a creditworthiness assessment before accepting the new terms, making it again very difficult in practice to re-arrange an existing credit agreement by mutual consent.[74] A similar, temporarily rule was made for mortgage credit agreement for movable purposes to prevent the forced sale of someone's house as a result of default due to a covid-19 infection.[75]

The latter obligation –i.e. to perform a creditworthiness analysis– was surprisingly exempted if the mutually agreed financial arrangement was made in the light of the covid-19 pandemic. One of the conditions for the exemption, though, is that the default is the result of the pandemic, which limits again the impact the exemption might have on consumers in default. It was a good solution during the pandemic, but nowadays no longer usable as current defaults generally do no longer originate from a covid-19 infection.

The first forbearance measure –consensual financial arrangements– is in Belgium thus not so successful to prevent judicial executory enforcement proceedings.

[72] It is questionable whether this strict *contra legem* interpretation by the FPS Economy can be maintained in the future given art. 35 (1) CCD 2023.

[73] Art. VII.145 CEL.

[74] Art. VII.145/1 CEL.

[75] Art. VII.145/2 CEL.

4 Judicial Forbearance Measures

In principle, request for (deferred) payment arrangements are to be addressed to the justice of the peace, which is the small claims court in the Belgian judicial system. However, in case of a mortgage credit agreement, the consumer must address the request to the attachment judge (given the possibility of the forced sale of the mortgaged dwelling).[76]

The consumer must demonstrate, among other things, to have acted in good faith. The consumer must not have contributed to the financial problems himself. Also, the borrower is not entitled to a judicial payment arrangement when: a) the consumer's goods are sold at the request of other creditors; b) the consumer is a fugitive; c) the consumer has not provided or has reduced the security that he or she was obliged to provide to the creditor, or d) the consumer is in a state of bankruptcy or apparent insolvency.[77]

Even if the consumer meets these conditions, the attachment judge is not obliged to grant judicial payment arrangements.

When judicial forbearance is granted, the attachment judge has discretionary powers to determine the content thereof. For instance, the consumer may be allowed temporary relief. Notwithstanding, these discretionary powers must be exercised with moderation and weighing the interests of the consumer and the creditor. As such, the court must consider the relief and other financial arrangements the consumer already enjoyed. In any event, the court may not waive the consumer's repayment obligation.[78]

In consumer credit law, the judicial payment arrangements lapse as soon as the consumer no longer fulfils the obligation imposed under the forbearance decision. In the absence of a similar provision in mortgage credit law, it is assumed that the judicial payment arrangements do not automatically expire in the event of a (new) default.[79] The creditor must thus request the attachment judge to declare forfeit of the judicial payment arrangement in the event of a new default by the consumer.[80]

[76] Art. VII.147/24 CEL.

[77] Art. 1337 Belgian Procedural Code; Dirix & Broeckx (2010) 531.

[78] Cass. 15 June 2006, *Pas.* 2006, I, 1421 and *TBBR* 2009, 40.

[79] Meulemans (1993) 394-395.

[80] De Leval (2007) 177.

Nevertheless, the consumer can always be held liable if he or she incorrectly fulfils the repayment obligation under the judicial payment arrangements and will not be entitled to new juridical payment arrangements. An exception to the latter is made when new facts have arisen since the previous judicial payment arrangements were granted, and these facts would justify granting new judicial payment arrangements.

A personal guarantor must respect the consumer's payment arrangements granted under the judicial forbearance.[81] In addition, the personal guarantor cannot circumvent these judicial payment arrangements by urging the consumer to pay and/or by claiming compensation from the consumer.[82] Furthermore, a personal guarantor cannot invoke the consumer's judicial payment arrangements against the creditor.[83] The creditor can address the personal guarantor directly. Finally, in the event that the personal guarantor also undergoes payment difficulties, he or she may request judicial payment arrangements for themselves.[84]

5 Mandatory Conciliation Procedure

When the consumer defaults on the mortgage credit agreement, a creditor holding a mortgage security right cannot immediately seize nor enforce the credit agreement by virtue of a court judgment or the notarial deed. The creditor is obliged to summon the consumer first to a conciliation procedure before the attachment judge.[85] The legislator obliges the lender to attempt to reach an amicable settlement.

The fact that conciliation procedure is mandatory is an important deviation from general procedural law. Under common Belgian procedural and contract law, parties are in principle not obliged to summon each other to conciliation proceedings before initiating enforcement proceedings.[86] Here, it is imposed to temper the mortgagee from reaching out to an executory enforcement of the mortgaged dwelling too easily or too rapidly in the event of (mere) payment difficulties of the consumer.[87]

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[81] Art. VII.147, § 1, al. 4 CEL.

[82] Dirix (1997) 24, no. 31.

[83] Dirix (1997) 24, no. 30-31.

[84] Art. VII.147/27 CEL.

[85] Art. VII.147, § 1, al. 1 CEL; de Corte (1993) 6; Dirix & Broeckx (2010) 532.

[86] Art. 731, al. 2 Belgian Procedural Code; Deconinck (1996) 1; Wagner (2007) 552-553.

[87] Preparatory Works to the WHK, *Parl. St.* Kamer 1990-91, no. 1742/1, 13; Attachment Judge Veurne 19 April 1995, *Act.dr.* 1996, 378; Attachment Judge Luik 15 June 1994, *JLMB* 1996, 1258; De Corte (1993) 6; Dejemeppe (2004) 1053; Jakhian (1994) 117.

This rationale has far-reaching impact on the mortgagee's right to foreclose the mortgaged dwelling. Therefore, most authors proclaim that the lender-mortgagee must start such a mandatory conciliation proceedings before every kind of executory enforcement whether over the mortgaged property or another immovable property.[88] They also argue that conciliation is mandatory before every kind of executory[89] enforcement of movable goods owned by the consumer, for instance before seizing the consumer's salary, rental income, etc. [90] The success of this broad interpretation lies in its discouraging effect for creditors who would try to circumvent the mandatory conciliation proceedings by enforcing the secured credit agreement by seizing other goods belonging to the consumer.[91]

Because the injunction to pay is the first (procedural) act of an executory enforcement, the creditor must summon the consumer to conciliation proceedings before the injunction to pay is served.[92]

Finally, it is important to highlight that the mandatory conciliation procedure is dictated under penalty of nullity of the entire enforcement procedure.[93] Only the consumer can invoke the nullity.[94] The consumer must prove that the following three cumulative conditions are fulfilled, namely that: a) the creditor has failed to summon him or her or has done so unlawfully; and b) his or her interests have been harmed

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88 CA Luik 9 September 2003, *RRD* 2003, 469; Attachment Judge Charleroi 12 February 2002, *JLMB* 2002, 1525; Attachment Judge Luik 6 March 1995, *Act.dr.* 1996, 370; Vannerom (2015) afl. 106, 135-142.

89 Though, not before mere conservatory enforcement actions taken by the mortgagee. See De Leval (2007) 137; Dirix (1992-93) 893; Dirix & Broeckx (2010) 532; Jakhian (1994) 118; Meulemans (1993) 370-371; Vanderhaeghen (2011) 67; Van Ingelghem (2002) 2.

90 Attachment Judge Kortrijk 9 March 2009, *RW* 2009-10, 370; Dirix (2002) 1263; Dirix & Broeckx (2010) 532; Meulemans (1993) 368-369; Van Ingelghem (2002) 2.

91 Meulemans (1993) 368-369.

92 CA Luik 6 May 1993, *JLMB* 1993, 1203, annotation De Leval; CA Ghent 9 March 1993, *RW* 1992-93, 1349; CA Brussels 25 May 1989, *JLMB* 1989, 1287; Attachment Judge Brussels 28 February 1994, *RNB* 1994, 509; Attachment Judge Nijvel 8 December 1993, *JLMB* 1994, 699, annotation De Leval; Attachment Judge Luik 20 September 1993, *JLMB* 1993, 1289, annotation De Leval; Attachment Judge Brussels 8 October 1991, *RW* 1993-94, 234, annotation Laenens; De Leval (2007) 173; Dirix & Broeckx (2010) 532; Laenens (1993-94) 234; Meulemans (1993) 374-376; Vanderhaeghen (2011) 67.

93 Art. VII.147/24 CEL.

94 Art. 861 Belgian Procedural Code; De Leval (2007) 173.

by the failure to comply with the mandatory conciliation proceedings;[95] and c) the intended legal purpose of this mandatory procedure has not been achieved.[96]

Concerning the second (and third condition), the question arises whether the mandatory conciliation proceedings are still useful if the creditor already tried to reach a negotiated outcome before the enforcement procedure was initiated. More specifically, the question arises whether the consumer's interests have been harmed if it appears from preliminary negotiations that the contracting parties will not reach a solution during the mandatory conciliation proceedings. According to certain legal doctrine and case law, the creditor must not engage in hopeless attempts to reach a negotiated solution. If it can demonstrate that prior negotiations were conducted in good faith and have led to a negative result, the creditor no longer must summon the consumer to the mandatory conciliation proceedings.[97]

Like the ombudsman, the attachment judge cannot impose a binding decision in the mandatory conciliation procedure. The outcome of the proceedings depends solely on the willingness of the creditor and the consumer. If a creditor does not show up, for instance, the judge can postpone the hearing.[98] However, if the creditor does not appear for the postponed hearing as well, the attachment judge must declare that no conciliation was reached between the parties. The role of the attachment judge is thus passive,[99] although the judge can make non-binding suggestions to reach a positive solution.[100]

If no amicable agreement can be reached, the executory enforcement procedure, as we know it under general procedural law, is initiated via an injunction to pay served

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[95] Art. 861 Belgian Procedural Code; Dirix & Broeckx (2010) 533; Vanderhaeghen (2011) 67. Some examples of supreme court cases in which the consumer could not prove that his interest was harmed: Cass. 30 September 1993, *Arr.Cass.* 1993, 781; Cass. 4 October 1984, *Arr.Cass.* 1984-85, 204; Cass. 15 February 1977, *Arr.Cass.* 1977, 661; Cass. 23 April 1976, *Arr.Cass.* 1976, 957. Some supreme court cases in which the nullity was ordered: Cass. 14 December 2000, *Arr.Cass.* 2000, 1994; Cass. 10 February 1975, *Arr.Cass.* 1975, 648.

[96] Art. 867 Belgian procedural Code; De Leval (2007) 173; Meulemans (1993) 373; Van Herreweghe (1993) 402; Wagner (2007) 279, 389-414.

97 CA Luik 15 December 1994, RNB 1996, 356; Attachment Judge Brussels 12 October 1999, RW 2000-01, 1608; Attachment Judge Brussels 1 February 1994, TBBR 1994, 431; Attachment Judge Luik 31 August 1993, JLMB 1993, 1205, annotation De Leval; De Corte (1993) 7; De Leval (1993) 276; Dirix & Broeckx (2010) 533; Moreau-Margrève (1993) 118.

[98] CA Luik 23 June 2003, *JLMB* 2004, 1050, annotation Dejemeppe.

[99] Art. 731-733 Belgian Procedural Code; Dirix (2010) 533.

[100] Meulemans (1993) 379.

to the mortgagor. If, on the contrary, a solution is found, then the official report of the attachment judge will supplement the mortgage credit agreement with the new payment conditions.[101]

6 Executory enforcement

Unfortunately, no statistic data is publicly available on the number of executory enforcement procedures of immovable residential property and the length of these procedures in Belgium.

In the past (before the adoption of the MCD) the average length of such a procedure –without considering appeals and/or other judicial actions and remedies– was said to be around 18 months. Currently, some practitioners indicate that the average length of an executory enforcement procedure would be between 12 and 18 months.

Forced public sales nowadays are generally conducted via the online platform of the Belgian public notaries, 'biddit.be'.[102]

During the lockdown and the covid-19 pandemic a moratorium was decreed. Creditors were upon certain conditions not allowed to pursue the forced sale of the mortgaged dwelling. This was more precisely the case when the payment difficulties arose due to the covid-19 pandemic (e.g. due to being temporarily unemployed during the lockdown, etc.).

The judicial executory enforcement procedure is strictly regulated and quite formalistic. Before the actual public sale of the house, many steps must be taken by the creditor. All steps are supervised by the attachment judge and/or subordinated to its discretionary decision. Perhaps, it is good to highlight that the attachment judge does not assess the credit agreement on the merits. If the consumer and/or the mortgagee objects for reasons linked to the mortgage credit agreement, they may start proceedings as to the merits before the tribunal of first instance. Although these court proceedings do not suspend, in principle, the attachment procedure, the attachment judge will in practice often postpone the decisions/agreement to proceed with the executory enforcement until a judgment on the merits of the case has been given (awaiting, if necessary, for a decision on appeal and/or by the supreme court).

[101] Art. 733 Belgian Procedural Code.

[102] See https://www.biddit.be/nl/landing.

VIII Conclusion

Belgian mortgage credit law is strictly regulated. The law goes further than the transposition of the MCD, by imposing very detailed precontractual information and advice duties on the lender. The creditworthiness assessment prior to the conclusion of the credit agreement was and is strictly regulated by demanding the lender to conduct a micro-financial assessment of each consumer and check the public credit register. Compliance is strictly overlooked by the FPS Economy, one of the supervising authorities. Belgian law even has a duty to abstain from granting mortgage credit if the consumer is registered in the negative hatch of the CKP.

There is a correlation between these precontractual duties, imposed on creditors, and the lower amount of defaults on mortgage credit in Belgium.

Some of these duties are now also found in the CCD 2023. It is recommendable that the European legislator would take them also into consideration and include them in the reform of the MCD.

The downside of the strict regulation of mortgage credit in Belgium is the lack of voluntary forbearance measures. Because the Belgian mortgage credit law and the FPS Economy request a new creditworthiness assessment for almost every mutually agreed modification of the credit agreement, creditors are very reluctant to renegotiate an ongoing mortgage credit agreement in the event of payment arrears. Indeed, the consumer has payment difficulties and creditors will –due to the new, negative creditworthiness assessment– need to abstain from granting credit.

The fact that Belgian law caps the funding loss in case of early repayment of mortgage credit agreements leads to almost no disputes in case of full or partial early repayments by the consumer. Also, these caps can be considered when reviewing the MCD.

Finally, the obligation to start mandatory conciliations before an executory enforcement of the consumer's assets certainly hinders lenders from speeding towards a judicial executory enforcement procedure when the consumer is only in minor payment default.

In conclusion, Belgian mortgage credit law offers some valuable insights to the European legislator in the course of the current review of the MCD.

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CHAPTER 2
NAVIGATING MORTGAGE MARKET ISSUES IN THE CZECH REPUBLIC: THE ROLE OF THE MCD

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I Introduction

Since the transposition of the Mortgage Credit Directive (MCD) into the Czech legal system in 2016, numerous challenges have emerged due to the unique characteristics of the Czech mortgage market. This chapter will first analyse the interpretation of the MCD in the Czech Republic and then focus on the obstacles that have arisen in the domestic market.

To provide context, the chapter begins with a description of the most important currently applicable legislation, covering both substantive rules on consumer credit in general and mortgages in particular, as well as procedural issues related to consumer rights and regulatory supervision. However, it is not a comprehensive overview of current legislative standards, nor does it cover all the issues that have affected the mortgage market. Rather, this chapter focuses on major topics that have played a key role in the Czech mortgage market in recent years.

Following this structure, the chapter discusses specific issues related to the transposition of the MCD in the Czech Republic and the application of its rules. First, it addresses the early repayment issue, which has been a frequent topic not only in academic circles but also in the mass media over the past few years. Second, it examines matters related to the creditworthiness analysis, scrutinizing the extent of consumer protection and the consequences of non-compliance by providers or intermediaries. Next, it assesses the role of intermediaries and brokers, including those from other Member States. Finally, it discusses various other limitations on mortgage providers that may exceed the MCD standards.

II Substantive Rules

Both the MCD and the Consumer Credit Directive (CCD 2008) were transposed into one domestic piece of legislation, the Consumer Credit Act (CCA)[1] that has been, since its adoption in 2016, amended ten times already.[2] Moreover, the rules on financial services in general are also contained in the Civil Code.[3] This dichotomy means that, in general, public law rules governing consumer loan provision and intermediation are contained in the CCA, whereas private law rules are in the Civil Code.

The CCA, which is 'predominantly designed with a 'normal consumer loan' in mind',[4] addresses issues such as the licensing of consumer credit providers and their supervision by the regulatory authority, while the Civil Code governs various aspects of the contractual relationship between consumers and financial institutions, including contract validity and the right of withdrawal.

The relationship between the CCA and the Civil Code can be compared to the relationship between the MCD (Mortgage Credit Directive) and other EU directives, such as the Consumer Financial Services Rights Directive (CFRD) and the Consumer Rights Directive (CRD). While the MCD regulates specific aspects of mortgage credit, the CFRD focuses on consumer rights in financial services, and the CRD focuses on general consumer rights in distance and off-premises contracts, excluding financial services. These directives have been implemented in the Czech legal system, with the MCD transposed into the CCA and both the CFRD and CRD transposed into the Civil Code.

For instance, the requirement to provide information to consumers is regulated by both Arts 94 ff. CCA and Art. 1843 of the Civil Code concerning distance consumer credit contracts, including mortgages. However, the CCA states that if a provider or intermediary complies with the CCA's information disclosure requirements, they are considered to have fulfilled their obligations under the Civil Code. Regarding the right

[1] Act no. 257/2016 Coll., on Consumer Credit, as amended.

[2] There have been only nine amendments to the CCA, which are Act 183/2017 Coll., Act 303/2017 Coll., Act 307/2018 Coll., Act 186/2020 Coll., Act 237/2020 Coll., Act 353/2021 Coll., Act 96/2022 Coll., Act 462/2023 Coll., and Act 85/2024 Coll. Some of these amendments included provisions with multiple effective dates. The most recent amendment, Act 85/2024 Coll., came into effect on 1 September 2024.
[3] Act no. 89/2012 Coll., Civil Code, as amended.

[4] Simon (2017) 112.

of withdrawal, the CCA stipulates that if a right to withdrawal exists under the CCA, the consumer does not have a general right to withdraw according to the Civil Code.

This difference in implementation leads to varying consequences for breaches of these regulations. Breaches of the CCA incur public law sanctions, while breaches of the Civil Code can result in private law claims by consumers. Specifically, violations of the CCA can lead to fines or other administrative measures for consumer credit providers or distributors, including licence revocation, imposed by the financial market supervisory authority. In contrast, breaches of the Civil Code can result in claims for defective performance, such as damages, which can only be asserted by the affected consumer.

In practice, if a consumer receives insufficient or incorrect information before concluding a credit agreement, they can seek redress under the Civil Code. This remedy may include the right to withdraw from the contract or a claim for damages for defective performance. However, if there is a more serious breach, such as granting credit without the necessary licence, the supervisory authority may intervene and impose sanctions under the CCA, including heavy fines or revocation of the credit provider's licence. This dual system of regulation aims to provide comprehensive consumer protection by combining preventive and remedial mechanisms. While the public law rules in the CCA ensure that credit providers maintain high standards in the provision of their services, the private law rules in the Civil Code provide individual consumers with the means to protect their rights in the event of a breach of contract.

In addition, this system allows for flexibility and adaptability within a changing financial environment. The regular amendments to the CCA allow for a rapid response to new challenges and trends in the consumer credit market, while the stability and generality of the Civil Code ensures the long-term protection of consumer rights. In this way, the Czech legal framework seeks to balance the need for effective regulation of financial services with the protection of individual consumer rights, which contributes to overall confidence in the financial system and ensures a high level of consumer protection.

Finally, there is one particularity when it comes to the institutions eligible to provide mortgages in the Czech Republic. These are financial institutions known as ‘building societies’ which can be characterised as banks specialized in offering building society loans that fall under the definition of mortgages both for the CCA and the MCD. However, these building society loans are distinct from ‘regular’ mortgages as they are exclusively accessible to those who participate in building societies’ savings plans, and not to the general public. These plans frequently include a buildings savings agreement, typically with governmental financial aid.[5]

III Procedural Issues

Further clarification is required about the involvement of governmental bodies in overseeing and implementing consumer rights in relation to loans.

1 Supervision

The Czech National Bank (CNB) supervises mortgage lenders and intermediaries in the Czech Republic. The CNB is the sole supervisory authority and therefore supervises both credit institutions providing consumer loans and other entities licensed to do so.[6] Its powers include not only the supervision of these entities, but also the ability to impose administrative sanctions on any person who provides or arranges consumer credit without a licence; the total administrative fine may reach up to CZK 20,000,000 (approx. EUR 800,000).[7]

The CNB also has the power to supervise compliance with the obligations set out in the CCA. As part of this activity, the CNB can carry out inspections, issue instructions and recommendations and, if necessary, order corrective measures. If the law is breached, the CNB may impose fines or other administrative measures, including the revocation of the licence. The CNB's decisions can be reviewed by administrative courts, which ensures independent control over its acts.

Within the European Union, the European Banking Authority (EBA) plays an important role. The EBA provides a framework for the harmonisation of supervision of financial institutions across the EU and ensures that national supervisors, such as the CNB, adhere to common standards and practices. The EBA also provides technical support and issues guidelines to improve the consistency and effectiveness of supervision across the EU. Although guidelines and other documents issued by the EBA and other European Supervisory Authorities are not enforceable in the Czech Republic as they do not contain any sanctions, when they are issued, the CNB usually

[5] Art 1(b) of the Act no. 96/1993 Coll., on building savings and state support for building savings, as amended.

[6] See for example Art 135 ff. CCA.

[7] Art 157(1)(d) CCA.

follows with a statement on its official website[8] that it will adhere to the guidelines in its supervisory practice pursuant to Art. 16(3) of Regulation (EU) No 1093/2010.[9]

Such cooperation between the CNB and the EBA is crucial for effective supervision of mortgage lenders and intermediaries in the Czech Republic. The EBA regularly carries out assessments of national supervisors to ensure that their practices meet European standards. If irregularities are found, the EBA may issue recommendations for corrective action. This mechanism contributes to ensuring that the supervision of financial institutions is consistent and effective across the EU.

The CNB also actively cooperates with other national supervisory authorities in the EU, which enables the sharing of information and experience. This cooperation is essential for the effective supervision of cross-border financial institutions and for addressing potential problems that may arise in the provision of services within the EU single market.

In domestic law, cooperation in the area of mortgage lending is enshrined in the CCA, which provides for the obligation of credit providers to share certain information with the CNB and other authorities, where required, to protect consumers or financial stability. Other specific examples include the rules for information exchange between supervisory authorities within the EU, which are enshrined in EU regulations and directives transposed into Czech law.

The CNB may also issue so called Measures of General Scope. These are legal instruments that lie in between a piece of legislation (such as a decree) and a decision rendered in a particular case. One of the examples is the Measures of General Scope setting the critical infrastructure in the field of financial markets and currency issued on 22 December 2023,[10] that contains list of particular components of the infrastructure operated both by the CNB and financial institutions that are considered to be part of the national critical infrastructure.

[8] Czech National Bank, Sdělení ČNB o obecných pokynech EBA k poskytování a sledování úvěrů 25.08.2020 (2020). Available at: https://www.cnb.cz/cs/dohled-financni-trh/legislativni-zakladna/obecne-pokyny-evropskych-organu-dohledu/Sdeleni-CNB-o-obecnych-pokynech-EBA-k-poskytovani-a-sledovani-uveru/

[9] Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC.

[10] Opatření obecné povahy, kterým se určují prvky kritické infrastruktury v odvětví finanční trh a měna (2023). Available at: https://www.cnb.cz/export/sites/cnb/cs/legislativa/.galleries/opatreni_obecne_povahy/oop_kriticke_infrastruktury_ft_a_mena_20240106.pdf. 2023/158451/CNB/420

Additionally, judicial review of CNB decisions is a key element towards ensuring fair and transparent supervision. If an entity affected by a CNB decision or Measures of General Scope is dissatisfied, it can file a lawsuit with the Municipal Court in Prague, which reviews the legality of the decision and can annul it if it finds that it was contrary to the law. This process ensures that CNB decisions are subject to independent judicial review, which contributes to legal certainty and to the protection of the rights of financial market actors.

While the judicial review may be appealing, the reality is somewhat distinct. As most of the major public authorities are located in Prague, the Municipal Court of Prague has the average longest length of proceedings amongst the administrative courts of the same level in the Czech Republic. In 2022, the average was 532 days and the median was 463 days. Moreover, for 10% of the caseload, the length of proceedings is 1,046 days or longer, which is also the longest amongst the same level courts in the Czech Republic.[11]

Additionally, both the plaintiff and the CNB have the right to appeal the decision of the first instance administrative court. The appeal is then handled by the Supreme Administrative Court. The average length of proceedings before this court was 355 days in 2022.[12]

As the decision of the Czech National Bank is legally enforceable despite its being appealed before the administrative court, not many market participants may want to undergo such lengthy and uncertain proceedings, especially given the prospect that neither the Municipal Court in Prague nor the Supreme Administrative Court may alter the decision but only annul it and return it back to the CNB for reconsideration.

Therefore, even if the extent of court review is correctly set, there exist practical challenges that prevent effective judicial examination of the exercise of the CNB's supervisory powers.
Overall, the supervision of mortgage lenders and intermediaries in the Czech Republic is ensured by a complex system that combines the CNB's national powers with the EBA's harmonisation measures. This system ensures that financial institutions operating on the Czech market comply with both national and European regulations and provides consumers with a high level of protection.

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[11] Ministerstvo spravedlnosti České republiky, České soudnictví 2022: Výroční statistická zpráva (2023).

[12] Advokátní deník, U správního soudu vzrostla délka řízení, trend se daří obracet, uvedl předseda, 25 May2023 (2023). Available at: https://advokatnidenik.cz/2023/05/25/u-spravniho-soudu-vzrostla-delka-rizeni-trend-se-dari-obracet-uvedl-predseda/

2 Alternative Mortgage Dispute Resolution

The other important institution with respect to enforcement of (mortgage) credit agreements is the Financial Arbitrator. This institution was established in 2002 as a means of settlement of disputes based on Art. 10 of the then applicable Directive 97/5/EC on cross-border credit transfers.[13] Currently, after more than fifteen amendments to the respective piece of legislation, the Financial Arbitrator has power to adjudicate disputes between consumers and financial institutions regarding a wide range of financial services, including consumer credit in general, and, more particularly, mortgages.

The arbitration process before the Financial Arbitration can only be initiated by the consumer and has two stages. In both instances, the first and the appellate one, the decision is taken by the Financial Arbitrator. The appellate decision of the Financial Arbitrator is final and binding for both parties. Nevertheless, should either of the parties not be satisfied with the outcome of the appellate process, they have the option to file a lawsuit in court. The subsequent proceedings following the appellate decision of the Financial Arbitrator are held by civil courts and, again, consist of a first instance and an appeal. Moreover, revision by the Supreme Court may be also permitted in these cases. Yet once again there is a limitation to the judicial review and the civil courts may only confirm the decision of the Financial Arbitrator or amend it; they cannot set aside the decision and refer the case back to the Financial Arbitrator. Despite there being multiple options of revision, the Financial Arbitrator is sought as the means for dispute resolution by the consumers mainly because of its speed, lower to no costs and language preference in comparison to the alternative, i.e. directly engaging civil courts.

The speediness is ensured by the Financial Arbitrator's obligation set in Art. 15(1) of the Act on the Financial Arbitrator to conclude the proceedings within 90 days since the submission of the consumer's complaint. This period may be prolonged only once for another 90 days.

Furthermore, the initiation of the proceeding is free as set out in Art. 18(2) of the Act on the Financial Arbitrator. The losing party also does not have to bear the costs of the winning party in comparison to civil proceedings, see Art. 18(1) of the Act on the Financial Arbitrator, cf. Art. 4(1) of the Act 549/1991 Coll., on Court Fees, as amended, with respect to the fee for initiation of the proceedings and Art. 142(1) of the Act on 99/1963 Coll., on Civil Procedure ('Civil Procedural Code'), with respect to the reimbursements of the costs to the winning party.

[13] General part of Explanatory Memorandum to the Act 229/2002 Coll, on the Financial Arbitrator, as amended ('Act on the Financial Arbitrator'). Available at: https://www.psp.cz/sqw/text/tiskt.sqw?o=3&ct=1097&ct1=0

Finally, the proceedings before the Financial Arbitrator are held in the language in which the underlying contract is alleged to be concluded or the communication with the institution was conveyed, according to Art. 13 of the Act on Financial Arbitrator. The civil proceedings, on the contrary, according to the Art. 18(2) of the Civil Procedural Code are always conducted in Czech language and only if this is not a mother tongue of a party, an interpreter is provided.

As the speed of proceedings, costs, and language barrier are the most crucial challenges that consumers must overcome,[14] not only when challenging the financial service provider before the courts, the Financial Arbitrator may significantly improve consumers' access to justice.

Disputes relating to consumer credit have accounted for more than half of the cases arbitrated by the Financial Arbitrator in the past three years.[15] Therefore, the Financial Arbitrator is very important in setting trends in the Czech Republic. While these decisions remain appealable to the civil courts, who have the final say, the Financial Arbitrator's findings are publicly available and constitute an important informal source of law for consumer credit and, in particular, for mortgages.

IV Early Repayment

The early repayment of mortgages in the Czech Republic is a significant topic, especially after the adoption of the amendment to the CCA published under the No. 462/2023 Coll. ('2023 CCA Amendment') that came into force on 1 September 2024. This part therefore deals with a detailed analysis of the legal framework, application in practice and the challenges associated with early repayment of mortgages, including the views of experts and media reactions.

As the MCD clearly states in its Art. 25(1), the debtor has the right to discharge fully or partially the obligations under a credit agreement prior to the expiry of that agreement. Nevertheless, according to the MCD, this early repayment may subject to conditions.

The CCA has been very progressive and consumer oriented since its adoption as Art. 117(1) CCA allows for all credit agreements to be discharged by early repayment at any time, so no conditions within the meaning of Art. 25(5) MCD are applicable under the Czech law.

First of all, it is worth mentioning that according to the original language of Art. 117(3)(c) CCA, a mortgage, as well as any other consumer credit, could have been

[14] Raban (2016) 417.

[15] See Annual Report 2022, Annual Report 2021 and Annual Report 2020 of the Financial Arbitrator. Available at: https://finarbitr.cz/cs/informace-pro-verejnost/vyrocni-zpravy.html

repaid early without any sanctions in a period for which there is no fixed lending rate or within 3 months after the creditor has communicated the new lending interest rate to the debtor.[16] Moreover, there were other situations under which the creditor could not impose any sanctions upon the consumer or its legal successor. These included repayment by the means of benefits from insurance designed to secure repayment of the loan, loans granted by way of overdraft facility, and also the event of death, long-term illness or disability of the debtor or their spouse. Finally, the debtor could repay early each year up to 25% of the principal without any sanction, although other conditions applied.[17]

However, the creditor could have been entitled to be reimbursed of expenses reasonably incurred by the early repayment under several circumstances. The amount of the reimbursement of costs may have not exceeded 1% of the early paid part of the total amount of the consumer credit if the period between the early paid part and the agreed end of the consumer credit exceeded one year. If such period was not more than one year, the amount of the reimbursement should have not exceeded 0.5% of the early paid part of the total amount of the consumer credit.

Nevertheless, these limitations were not applicable to the reasonably incurred costs that the creditor was entitled to claim in connection with the early repayment of mortgages. There were many instances where early repayment of a mortgage would only entail partial compensation for such costs. For example, if the property the acquisition, construction or retention of which was either financed or secured by that mortgage was sold, the consumer was entitled to repay the mortgage in full early, on condition that the duration of the mortgage agreement exceeded 24 months, and the creditor was entitled to claim compensation for the reasonably incurred costs that could not exceed 1% of the amount of the mortgage credit repaid early, up to a maximum of CZK 50,000 (approx. EUR 2,000).[18] If early repayment did not fall into an exception, the general rule whereby the creditor was entitled to recover the reasonably incurred costs applied in full. Unfortunately, the law did not define exactly what constituted reasonably incurred costs.

In an attempt to clear this matter, the CNB responded to recurring questions from the public and credit providers with a general opinion providing an interpretation of the term ‘reasonably incurred costs’ in March 2019. It stated that these are mainly administrative costs of the provider, i.e. costs such as the salary of the employee who processes the early repayment application, land registry fees, postage, printing and copying costs of documents, telephone charges or office supplies consumed.[19] There

[16] Art 117(3)(d) CCA.

[17] § 117(3)(f).

[18] Art 117(4) CCA.

may have also been fees for any notarial acts required by the early repayment. Conversely, costs such as commissions paid by the lender to the broker for arranging the mortgage or the reduction in the lender's interest income after the early repayment of the mortgage or its interest expense on the debt could not be considered to be reasonably incurred costs.[20]

Furthermore, in 2021, as a response to the question of what fees a provider could charge for early repayment of a mortgage or building society loan, the Financial Arbitrator reached the same conclusion as the CNB, i.e. that banks could not charge clients for costs related to a reduction in interest income or, for example, for expenses related to a commission to an intermediary, as this is not a cost, but a lost profit.[21]

As a consequence of this, representatives of Czech banking institutions and the Czech Banking Association[22] tried to persuade the CNB to change its interpretation, and at the same time sought to amend the law to set clearer and fairer rules for all parties involved. Interest in early repayment of mortgages has increased due to falling interest rates, leading clients to early repay and refinance more often. Banks have warned that keeping early repayment fees low will lead to shorter fixed interest rate periods. Some banks have already started to support fixing the interest rate for three years, with more favourable rates, and have stopped offering fixed interest rates over seven years.[23]

As a result of these efforts the Parliament approved the 2023 CCA Amendment in 2023, which changes the regulation for the early repayment conditions for mortgages.

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[19] Jaké náklady může věřitel požadovat nahradit po spotřebiteli v souvislosti s předčasným splacením spotřebitelského úvěru na bydlení? Available at: https://www.cnb.cz/cs/dohled-financni-trh/legislativni-zakladna/stanoviska-k-regulaci-financniho-trhu/RS2019-07/

[20] ČNB vydala stanovisko, jaké náklady mohou banky účtovat za předčasné splacení spotřebitelského úvěru na bydlení. Available at: https://www.cnb.cz/cs/cnb-news/tiskove-zpravy/CNB-vydala-stanovisko-jake-naklady-mohou-banky-uctovat-za-predcasne-splaceni-spotrebitelskeho-uveru-na-bydleni/

[21]P. Kučera in Peníze.cz, Předčasné splacení hypotéky: Vysoký poplatek odmítá i finanční arbitr. Available at: https://www.penize.cz/hypoteky/424820-predcasne-splaceni-hypoteky-vysoky-poplatek-odmita-i-financni-arbitr.

[22] According to its webpage, M. Czech Banking Association - About us, 2024, Czech Banking Association (CBA) is 'a voluntary association of banks and building societies operating on the Czech market. Currently, we associate 32 members representing more than 99 % of the Czech banking sector. We have been supporting the development of the Czech banking sector, our entire economy and the financial literacy of Czechs since 1990'. Available at: https://cbaonline.cz/en

[23] O. Skalková in Peníze.cz, *Hypotéky míří k dalšímu rekordu. Podporujeme kratší fixace, říká bankéř* (2021). Available at: https://www.penize.cz/hypoteky/424967-hypoteky-miri-k-dalsimu-rekordu-podporujeme-kratsi-fixace-rika-banker

This amendment introduces several important changes to the existing framework, aiming to balance the interests of consumers and creditors.

In addition to the above-mentioned cases where early repayment is already possible without a fee, the Amendment extends this option to instances where the spouses' community property is settled (e.g. a borrower's divorce) or the sale of the property occurs two or more years after its purchase. In other situations where the consumer intends to prematurely repay the mortgage before the expiry of the fixed interest rate period (so-called 'mortage tourism' in the Czech Republic) and switch to another bank with a better interest rate offer, the 2023 CCA Amendment will allow the original bank to charge the client a fee of up to 2% only on the unpaid part of the principal. The fee should offset the fact that the early repayment of the mortgage will end the interest income the bank had counted on for the fixed interest rate period.[24] The amendment maintains the existing right to repay 25% of the original principal of the loan each year free of charge under any conditions.

As is clear from the above, the early repayment of mortgages in the Czech Republic has been a significant topic, particularly following the adoption of the 2023 CCA Amendment. The new rules provide more flexibility for borrowers, while also ensuring that lenders' legitimate interests are protected.

When compared to the MCD rules, the Czech framework appears more consumer friendly. The MCD allows for early repayment but permits lenders to impose conditions, whereas the Czech law has historically allowed for more unrestricted early repayments. However, both regulations ensure that any fees charged must reflect the actual costs incurred by the lender. The Czech approach, especially with the recent amendment, aligns with the MCD's principles while offering broader protections to borrowers. The CNB's interpretation of 'reasonably incurred costs' and the subsequent legal changes have provided guidelines, ensuring that the interests of both parties are fairly represented.

In conclusion, the 2023 CCA Amendment represents an evolution of the mortgage repayment framework in the Czech Republic. It provides borrowers with greater flexibility to manage their financial obligations in various life circumstances while safeguarding the legitimate interests of creditors. By comparing these rules with the MCD, it's evident that the Czech approach continues to prioritize consumer protection, setting a high standard for mortgage regulations.

[24] Explanatory Memorandum to the 2023 CCA Amendment, 86, available online at https://www.psp.cz/sqw/text/orig2.sqw?idd=228455

V Creditworthiness Assessment

The historical development of the assessment of consumer creditworthiness in the Czech Republic and its legal regulation has changed significantly in recent decades. The first legislative milestone was Act No. 145/2010 Coll., on Consumer Credit, which introduced the obligation for creditors to assess the consumer's ability to repay the loan on the basis of sufficient information obtained from the consumer and from other sources, including consumer credit databases.
The above-mentioned 2010 law on Consumer Credit stipulated that if creditors fail to comply with this obligation, the credit agreement is void. This was later adopted by the CCA. The fact that the credit agreement is void means in this particular case that the consumer may, according to Art. 87(1) CCA, repay the outstanding amount of the consumer credit in a deadline that is 'appropriate to their abilities'. Should there be a dispute between the financial institution and the consumer as to what is appropriate in a particular case, the court shall decide.

However, in the case 33 Cdo 1819/2023 of 27 September 2023, the Supreme Court concluded that a consumer credit agreement cannot be considered void simply because the consumer's creditworthiness has not been properly assessed; it must be established that the consumer was unable to repay the credit (or that the credit should not have been granted). In other words, the consumer agreement is not void in case the financial institution did not do the creditworthiness assessment correctly, but had they done it, the consumer would have passed.

This approach is a special one in the Czech law and preferential to the general rules of voidness of a contract. In other cases, should a contract be void, the provided consideration based on a void contract constitutes unjust enrichment and, according to Art. 2993 of the Civil Code, the party to a contract that has performed without there being a valid obligation is entitled to recover what it has performed without delay.

Another key piece of legislation regarding the creditworthiness assessment was the CCA itself. This act, specifically its Art. 86, requires creditors to thoroughly assess the creditworthiness of the consumer based on necessary, reliable and sufficient information. The law also emphasises that the information must be obtained not only from the consumer, but also from relevant internal and external sources, including databases.

A significant change was the tightening of the requirements for verification of information provided by the consumer. The amendment to Act No. 43/2020 Coll. (2020 CCA Amendment) imposed an obligation on creditors not only to obtain information from the consumer but also to verify it independently. For example, creditors must verify the consumer's income for at least three months preceding the mortgage and other credit application, which was emphasised in the amended text of the law.

The 2020 CCA Amendment also introduced an obligation for creditors to carefully document and retain all information obtained during the creditworthiness assessment in order to be able to demonstrate retrospectively that they acted with professional care. Creditors have to conduct additional verification of the information if any irregularities are found to ensure that consumers have sufficient means to repay the loan and do not get into financial difficulties by obtaining it from the provider.

Another development to the process came with the 2024 CCA Amendment, partially effective as of 1 January 2024, which introduced several substantial modifications. In particular, the amendment clarified the requirements for assessing creditworthiness and extended the obligations of creditors. For example, a new provision was introduced stating that the credit provider must consider not only income but also any expenses related to the ownership of property, in particular immovable property, when assessing the consumer's ability to repay the loan. This provision has been added to Art. 86(1)(a) CCA. It now reads:

> ‘Before concluding a consumer credit agreement or amending an obligation under such an agreement consisting in a significant increase in the total amount of consumer credit, the creditor shall thoroughly assess the consumer's creditworthiness on the basis of information that is necessary, reliable, sufficient and proportionate to the nature, duration and nature of the consumer's credit, the amount and the riskiness of the credit to the consumer information obtained from relevant internal or external sources, including from the consumer and, where necessary, from a database enabling an assessment of the consumer's creditworthiness or from other sources, taking into account any expenses related to the ownership of the consumer's assets, in particular real estate.’

1 Historical Background of the 2024 CCA Amendment

The European Union has played an important role in this area through directives and regulations aimed at harmonising creditworthiness assessment procedures across Member States. CCD and MCD require Member States to ensure that creditors thoroughly assess the creditworthiness of a consumer on the basis of sufficient information before entering into a credit agreement.

In 2015, the EBA issued final guidelines on creditworthiness assessments in the context of the implementation of the MCD. These guidelines were designed to ensure consistent consumer protection across the EU and set out requirements for policies and procedures for the early identification and resolution of consumers' payment difficulties. The EBA also highlighted the need to establish binding principles for responsible lending, which would include an obligation to take into account the interests, objectives and characteristics of target consumers when designing credit products.[25] These guidelines have been enforced by the CNB.[26]

Furthermore, in 2020, the EBA cancelled these guidelines and as a replacement and an upgrade issued guidelines on loan origination and monitoring that are applicable not only to MCD loans but also to CCD credit agreements.[27] Again the CNB decided to enforce these guidelines in its supervisory practice.[28]

In addition to this, the CNB issued in 2023 an opinion on the creditworthiness assessment process (2023 CNB Opinion) applicable both to CCD and MCD credit agreement origination process.[29] The opinion from the CNB on the possibility of considering consumer assets in creditworthiness assessments under the CCA clarifies that lenders must compare the consumer's income and expenses in accordance with Art. 86(2) CCA. The assessment must primarily focus on the consumer's ability to repay the loan through regular income, but it can also include the consumer's assets under certain conditions. For instance, if the loan is expected to be repaid from the sale of the consumer's assets, this aspect must be clearly stipulated in the loan agreement, and the lender must have a reasonable expectation of the asset's sale and its proceeds. This ensures that the assessment of creditworthiness remains thorough and reliable, even when assets are considered as part of the consumer's financial evaluation.

The intention behind including assets is not to provide an alternative to income assessment but to supplement it in cases where the consumer's overall financial

[25] EBA, Final Report: Guidelines on creditworthiness assessment EBA/GL/2015/11 (2015). Available at: http://www.eba.europa.eu/documents/10180/1092161/EBA-GL-2015-11+Guidelines+on+creditworthiness+assessment.pdf/f4812d37-06c4-42e4-a9e7-e3cf18501093

[26] Czech National Bank, Sdělení ČNB o obecných pokynech k posouzení úvěruschopnosti 01 June 2015 (2015).
Available at: https://www.cnb.cz/cs/dohled-financni-trh/legislativni-zakladna/obecne-pokyny-evropskych-organu-dohledu/Sdeleni-CNB-o-obecnych-pokynech-k-posouzeni-uveruschopnosti/

[27] EBA, Final Report on Guidelines on loan origination and monitoring EBA-GL-2020-06 (2020). Available at: https://www.cnb.cz/cs/dohled-financni-trh/.galleries/legislativni_zakladna/obecne_pokyny_evropskych_organu_dohledu/eba_gl_2020_06_cs

[28] Czech National Bank, Sdělení ČNB o obecných pokynech EBA k poskytování a sledování úvěrů 25.08.2020 (2020). Available at: https://www.cnb.cz/cs/dohled-financni-trh/legislativni-zakladna/obecne-pokyny-evropskych-organu-dohledu/Sdeleni-CNB-o-obecnych-pokynech-EBA-k-poskytovani-a-sledovani-uveru/

[29] Stanovisko České národní banky: K možnosti zohlednění majetku/aktiv v rámci posouzení úvěruschopnosti spotřebitele podle zákona o spotřebitelském úvěru (2023). Available at: Https://www.cnb.cz/cs/dohled-financni-trh/legislativni-zakladna/stanoviska-k-regulaci-financniho-trhu/RS2023-25 ročník 2023, RS2023-25.

situation, including assets, clearly demonstrates the ability to repay the loan. This holistic approach therefore aims to enhance the robustness of creditworthiness assessments, ensuring consumer protection and financial stability. Even in scenarios where the consumer's income is deemed insufficient, the thorough assessment of their assets can justify a positive creditworthiness assessment if it is evident that the consumer can meet the repayment obligations without this causing financial distress.

In summary, the 2023 CNB Opinion aligns with the EBA broader regulatory framework, underscoring the importance of a comprehensive evaluation of both income and assets in determining a consumer's creditworthiness. This opinion thus ensured that lenders maintain a balanced approach, focusing on sustainable lending practices that protect consumers and promote financial stability.

Overall, the historical development of consumer credit assessment legislation and supervisory authority opinion shows an increasing emphasis on consumer protection and harmonisation of rules across the European Union. These developments are essential to ensure financial stability and the protection of consumer rights in a dynamic and often complex financial environment.

2 Case Law

Following the discussion of the legislative developments, it is also necessary to analyse law in action, i.e. how the rules are applied in practice with respect to the scope of creditworthiness assessment. Case law has been playing a key role in the interpretation and application of the law relating to the assessment of consumer creditworthiness. Court decisions provide guidance to lenders on how to properly assess consumers' ability to repay and help set standards that ensure consumer protection and responsible lending.

The Supreme Court of the Czech Republic has repeatedly addressed in its case law the question of what steps creditors must take to meet their obligation to assess a consumer's creditworthiness with professional care. In its judgment 33 Cdo 2178/2018 of 25 July 2018, the Supreme Court stated that a creditor fails to comply with the duty to exercise professional care if it relies solely on the debtor's personal statement of income and assets without verifying this information from independent sources. This judgment emphasises that creditors must verify not only the income but also the consumer's expenses and other relevant factors which may affect the borrower’s ability to repay the loan. This case law may be seen as obsolete now, after the adoption of the 2020 CCA Amendment that also implemented this rule. Nevertheless, it is not the case, as the contract is governed by the legislative rules applicable at the time of its formation. Therefore, this decision is still relevant for mortgage agreements entered into before the applicability of the 2020 CCA Amendment.

Another important case tried by the Supreme Court in this respect is case 20 Cdo 1063/2023 of 2 May 2023. In this case, the Supreme Court stated that the conclusion of a debt acknowledgement agreement with a repayment schedule, with a newly fixed maturity of an existing debt and its increase by a not insignificant contractual penalty for breach of the obligation to repay the consumer credit on the newly fixed maturity date, which the parties had reason to expect at the time of the acknowledgement, constitutes an amendment to the consumer credit agreement consisting in a significant increase in the total amount of the consumer credit, and as a result of which the creditor is obliged to assess the creditworthiness of the debtor again. Despite the fact this other case was rendered with respect to the laws applicable before the CCA, it is applicable even for situations arising under the CCA.

The Financial Arbitrator, in its decision FA/SR/SU/286/2020-32 of 25 June 2021, stressed that creditors should base their search for relevant information not only on information supplied by the consumer but also on information obtained from other available sources. The Arbitrator stated that creditors have a duty to consult databases collecting information on the consumer's pre-existing credit relationships. This approach helps to ensure that creditors have as complete a picture as possible of the consumer's financial situation.

Another important decision is the judgment of the Supreme Administrative Court As 30/2015, which confirmed that creditors must exercise professional care when assessing creditworthiness and cannot rely solely on the consumer's personal statements. This approach ensures the objectivity and accuracy of the creditworthiness assessment. The judgment also stresses that creditors should use available databases and other sources of information to verify the consumer's financial situation.

In its decision III ÚS 4129/18 of 26 February 2019, the Constitutional Court of the Czech Republic emphasised that entering into a credit agreement with a consumer who is unable to repay the loan is contrary to good morals. This judgment points out that lenders have a duty to thoroughly assess the consumer's ability to repay the loan and that the general courts should guide lenders in a convincing examination of the borrower's ability to repay the loan. The decision emphasises that this requirement is not unreasonable, but rather a fundamental principle of responsible lending.

In its judgment 39 Co 377/2023 of 21 February 2024, the Municipal Court in Prague ruled that if the creditor erred in its creditworthiness assessment, this may result in the invalidity of the credit agreement. The court emphasised that creditors must prove that they have exercised professional care in assessing creditworthiness and that the information obtained from the consumer has been thoroughly verified. This judgment underlines the importance of carefully and consistently gathering and verifying information about the consumer's financial situation.

The judgment of the Regional Court in Brno 13 Co 179/2022-581 of 20 October 2022 also emphasised that creditors must verify information on the consumer's income and expenditure from independent sources. The court stated that merely consulting the Central Register of Executions and the Insolvency Register is not sufficient to assess creditworthiness. Creditors must request and verify claims about the consumer's income, for example, by confirmation from the employer, and compare them with available data on the average expenditure of the population.

In its decision FA/SR/SU/779/2019-21 of 3 November 2019, the Financial Arbitrator stated that the professional diligence criterion was not met because the consumer's income was ascertained from the months of January to June, with the contract not being entered into until four to six months later. The arbitrator emphasised that it is not enough to verify that the consumer is not undergoing enforcement or insolvency proceedings, but that the consumer's specific expenses, such as housing, food, or transportation costs, must also be thoroughly verified.

In its judgment of 26 March 2024 in 32 C 175/2023-140, the District Court of Strakonice held that, in assessing creditworthiness, all relevant information, including the consumer's income and expenditure, must be considered and verified from available sources. In the case of mortgages, the court found that the financial institution had fulfilled its duty to assess creditworthiness by requesting and verifying the consumer's income and expenditure data, comparing it with data in internal and external registers and determining a reasonable level of expenditure.

The caselaw is therefore clear that creditors have a duty to exercise professional care in assessing the creditworthiness of consumers, to verify thoroughly all relevant information and to ensure that credit is granted responsibly. This approach ensures not only consumer protection but also stability and confidence in the financial market.

VI Intermediation and Brokers

Broker operations that are referred to as 'tipařství' in Czech (a term which may be translated as 'tippers' in English), exert a substantial impact on the mortgage market in the Czech Republic. This section examines the legal framework and practical elements of broker operations in regard to the provision of mortgage loans. This also section offers a discussion of the EBA guidelines.

Brokers play a vital role in the financial services business as intermediaries who source potential clients. These brokers' aim is to locate potential clients who may have an interest in financial services, such as mortgage loans. They then provide the contact information of these persons to licenced intermediaries who are able to offer expert advice and sell financial products. Brokers, unlike licenced intermediaries, operate without supervision from the CNB and are not obliged to possess professional credentials or registration.

The CCA delineates the responsibilities and constraints of brokers. Brokers are legally permitted to collect and transmit contact information of potential clients exclusively to licenced intermediaries. Their operations are classified as subject to CNB regulation, which prohibits them from offering detailed financial advice or promoting specific goods and it is up to the represented financial institution to ensure they do not overstep the permitted scope of their activities.[30]

The primary differentiation between brokers and financial intermediaries is based on the degree of involvement and specialised knowledge needed. Financial intermediaries are authorised experts who can evaluate the particular requirements of clients, provide customised guidance, and smooth the transaction of financial products. Brokers, in contrast, work at an initial stage where they discover potential clients without engaging in in-depth discussions about specific financial needs or product offerings.[31]

The CNB has clearly defined the demarcation between broker activity and financial intermediation for the services conducted in financial markets. Brokers are authorised to offer general information regarding the availability of specific financial products, but they are prohibited from engaging in any form of persuasion or providing detailed advice that may sway the client's decision towards a particular product or service.[32]

Brokers operate as the first point of contact in the process of acquiring customers. Their main purpose is marketing-oriented, with a focus on identifying individuals who demonstrate an initial interest in mortgage loans. After identifying these potential clients, their information is passed on to licenced intermediaries who then assume responsibility for providing advice and facilitating the sales process.

The lack of regulation for brokers presents specific difficulties. Although it enables a wider range of people to participate in these activities without strict admission criteria, it also raises questions about the accuracy and reliability of the information presented to potential clients. Errors or distortions during this early phase may result in clients considering inappropriate financial products or having unrealistic

[30] Ježdík (2020) 27.

[31] Slanina, Jemelka, Vetešník, Wachtlová & Flídr (2017) 60.

[32] Czech National Bank, Které činnosti při poskytování investičních služeb vyžadují složení odborné zkoušky podle ZPKT? 16. 11. 2017 (2017). Available at: https://www.cnb.cz/cs/dohled-financni-trh/legislativni-zakladna/stanoviska-k-regulaci-financniho-trhu/RS2017-25/

expectations, therefore it is important for the regulation to clearly distinguish between regulated and unregulated activities.[33]

The integration of these EBA guidelines, particularly of EBA GL 2020, into the Czech regulatory framework further delineates the responsibilities of brokers and licensed intermediaries. Brokers must adhere to these guidelines by ensuring that any preliminary information they provide is accurate and does not mislead potential clients. Licensed intermediaries, on the other hand, must follow the detailed procedures outlined in the guidelines to assess creditworthiness and manage arrears effectively.

In conclusion, broker activities in the Czech mortgage market are a critical component of the customer acquisition strategy for financial intermediaries. By focusing on identifying and referring potential clients, brokers facilitate the flow of customers into the regulated financial advisory sector. However, maintaining the integrity and clarity of these roles is essential to protect consumers and ensure they receive appropriate and regulated financial advice. The regulatory environment, while providing a clear framework, also necessitates vigilance to prevent the blurring of lines between unregulated and regulated activities.

VII Restrictions on Other Contractual Arrangements

The regulation of consumer credit contracts in the Czech Republic involves several critical restrictions to protect consumers and ensure fair lending practices. These restrictions are laid out in various legislative provisions and guidelines to ensure that consumer credit agreements are transparent, fair, and do not place undue burden on the borrower.

First, according to Arts 104 and 105(1) CCA, consumer credit agreements must be provided in written form and must be delivered to the consumer in a durable medium, such as paper or another permanent data carrier. These agreements should include comprehensive details about the credit, including the addresses and contact information of both parties, the type and duration of the credit, the total amount of credit, conditions for its withdrawal, the number and frequency of payments, and the total cost of the credit including the annual percentage rate of charge (APRC).

One of the significant restrictions is the prohibition of using bills of exchange or checks for the fulfilment or securing of consumer credit stated in Art. 112(1) CCA, with the exception of mortgages that cannot be secured by immovables for a transitional period. Such mortgages may be, according to Art. 112(2) CCA, secured by a promissory note not to order, which the creditor shall return to the consumer immediately after the mortgage has been secured by an immovable property. This

[33] Hobza (2017).

measure is in place to prevent the misuse of these instruments, which can often lead to additional financial liabilities for consumers beyond the agreed terms of the credit.

Moreover, according to Art. 115(1) CCA, the conclusion of a consumer credit contract cannot be conditional on the conclusion of another contract with three minor exceptions. Those three exceptions do not mirror the scope of Art. 12(2) MCD as tying practices are allowed only in case of a free payment or savings account whose purpose is to accumulate funds for the repayment or servicing of consumer credit, or building savings according to the law regulating building savings (please see above), or insurance for the vehicle financed by the consumer credit. Whereas the first exception falls within the scope of Art. 12(2)(a) MCD and goes beyond the requirements there as the account has to be free, the compatibility of the second exception and possibly the third with the MCD is not clear.

The aim of the second exception is to allow building societies to provide loans only to their clients, who have concluded buildings savings agreements with them. This rationale is not included in the CCA but as there cannot be another interpretation consistent with EU law, it is the only possible one[34].

With respect to the latest exception, it is clear it would be solely governed by the CCD 2008 that allows such practices as it does not contain any provision on tying and bundling practices. If in an extreme case this exception applied to consumer credit governed by the MCD, the provision would be clearly against Art. 12(1) MCD.

To provide an example of the prohibited practices, a creditor cannot require a consumer to purchase an insurance policy or any other additional service as a condition for granting the credit, unless such an insurance is directly related to the credit itself, such as payment protection insurance. Even in such cases, borrowers must have the freedom to choose their own insurer, except for the vehicle insurance.

In cases of default, the contract may, according to Art. 122 CCA, provide for default interest and compensation for reasonably incurred costs related to the delay. However, the amount of default interest must not exceed the rate prescribed by law. Additionally, any agreed contractual penalty for default must be reasonable and cannot exceed 0.1% per day of the outstanding amount. The cumulative total of all contractual penalties applied must not exceed 50% of the total amount of the consumer credit, with an absolute cap of CZK 200.000. This cap is constructed only for contractual penalties, the other payments related to the default, namely the default interest, may exceed this sum.

Art. 113 CCA also specifies that if consumer credit is secured by collateral, including immovable, the value of the collateral must not be disproportionate with regard to the

[34] Slanina (2017) 571.

value of the secured claim at the time of the credit agreement, with the exception of mortgages or building society loans. The valuation of the collateral must be in any case fair, impartial, and documented in a durable medium. Professionals performing the valuation must be trustworthy, competent, and sufficiently independent from the credit issuance process.

These restrictions aim to create a balanced framework where the interests of both lenders and borrowers are protected. They ensure that consumer credit agreements are not only transparent and fair but also that they do not impose excessive obligations on consumers, thereby promoting responsible lending practices.

VIII Conclusion

Ultimately, the incorporation of the MCD into the Czech legal framework has resulted in substantial modifications and difficulties within the mortgage industry. The implementation of the CCA in 2016, together with subsequent modifications, has sought to align Czech legislation with European norms, while also considering specific characteristics of the local market. The main objective of these legislative measures has been to improve consumer protection, promote responsible lending, and provide comprehensive regulatory structures that are in line with the ideals of the MCD.

An area which has generated discussion is that of early repayment of mortgage debts. The 2023 CCA Amendment, scheduled to be implemented in September 2024, offers additional regulations that enhance borrowers' flexibility and safeguard lenders' lawful interests. This amendment achieves a harmonious compromise between the rights of consumers and the stability of the financial system by permitting early payback with minimum fees under specific circumstances. The Czech Republic's dedication to consumer-friendly policies is highlighted by this proactive approach, which also ensures compatibility with broader European norms.

The evaluation of creditworthiness has also experienced substantial transformation. The CCA's rigorous criteria for verifying customer information and documenting credit assessments guarantee that lenders operate with professionalism and thoroughness. The comprehensive assessment procedure not only protects customers from excessive debt but also strengthens the stability of the financial market. The revisions implemented in 2020 and 2024 enhance and streamline these procedures, encompassing more comprehensive factors such as property-associated costs and long-term financial security.

Intermediaries, such as brokers, have played a crucial role in the Czech mortgage market. The explicit allocation of duties between brokers and authorised financial intermediaries aids in upholding market integrity and fostering consumer confidence. By providing clear regulations, consumers are guaranteed to obtain suitable and controlled financial guidance, which in turn promotes a mortgage market that is more transparent and dependable. In addition, the creation of the Financial Arbitrator as a form of alternative dispute resolution has greatly enhanced consumers' ability to seek justice. The Financial Arbitrator facilitates the efficient resolution of conflicts by providing a faster, more economical, and linguistically accessible approach. This institution is essential in influencing the development of informal case law patterns and offering customers a convenient means to handle complaints about mortgage agreements.

In general, the Czech approach to implementing the MCD and regulating the mortgage sector demonstrates a strong dedication to safeguarding consumers and ensuring financial stability. The ongoing revisions and adjustments of the CCA showcase a flexible and proactive legal structure that can effectively tackle developing difficulties. The Czech Republic sets a good example by adhering to high standards for consumer rights and creditor duties that go above the level required by the MCD.

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CHAPTER 3

FRENCH LAW AND THE CHALLENGES OF A NEW MORTGAGE CREDIT DIRECTIVE

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I Introduction

The Directive of 4 February 2014 on credit agreements for consumers relating to residential immovable property (MCD), was transposed into French law by Ordinance no. 2016-351 of 25 March 2016, which was ratified by a Law of 21 February 2017. This ordinance significantly modified French mortgage law, but also the legal framework for mortgage intermediaries. The new obligations on banking establishments and mortgage intermediaries have been transposed into the Consumer Code and the Monetary and Financial Code. In the Consumer Code, the transposition of the MDC led to the amendment of Arts L313-1 to L313-64. The legislator wanted to prevent the system put in place to protect consumers from being circumvented. For this reason, Art. L314-26 of the French Consumer Code stipulates that the provisions applicable in this area are of public policy.

Although the transposition of the MCD directive has led to changes in French law, this European text has not had any impact on it. Indeed, French provisions on mortgage credit were already largely designed to protect the borrower. This consumer protection will have to be enriched when the new MCD is adopted. Positive law must be adapted to new contract formation methods, such as the use of the Internet and artificial intelligence. But the contract performance phase must not be forgotten. On this point, a number of provisions in French law could inspire the European legislator.

Questions relating to the adoption of a new MCD will be addressed through a study of the scope of the provisions arising from the MCD (II), certain rules applicable to the formation of the credit agreement (III), the establishment of a link between the credit agreement and the sale of immovable property (IV) and the rules applicable during the term of the credit (V).

II Scope of the Provisions Deriving from the MCD

In order to clarify the scope of application of the provisions of the directive in French law, we will first identify the credit agreements to which the provisions of the MCD apply (I.1) and those which are excluded (I.2).

1 Credit Agreements Covered by the MCD

1.1 General Rules

Under French law, a credit agreement is defined in Art. L311-1-6° of the Consumer Code as a contract under which a lender grants or undertakes to grant a borrower credit in the form of a deferred payment or a loan, and under which the borrower settles the cost in instalments. Residential credit is not defined in law; only its scope is specified. However, legal doctrine has defined it as ‘a loan of money or deferred payment, intended to finance the acquisition, construction, repair or improvement of a residential property by persons who are not pursuing a professional or commercial objective'.[1]

The rules on residential credit apply to all loans that meet this description, whatever their qualification or technique. These rules therefore apply equally to credit agreements under ordinary law, concluded by private agreement or notarial deed, and to subsidised loans, such as the 'prêt épargne-logement'.[2] As for the loan technique, the *Cour de cassation* has adopted an extensive definition of the scope of the provisions stemming from the MCD. It has ruled, for example, that a credit agreement granted after the sale of a property, to pay off the outstanding balance on the initial loan granted for the purchase of the property, is part of the transaction for the acquisition of the property and is therefore subject to the rules governing residential credit.[3]

1.2 The Special Case of Credit Consolidation

Credit consolidation is a financial operation involving the repayment of all credits (mortgages, consumer credit, home improvement loans, etc.) taken out with one or more credit institutions, by means of a single credit granted by a bank specialised in this type of operation. In France, this practice has grown in recent years as a result of increasing household indebtedness. This operation is often dangerous for the consumer. Indeed, credit consolidation is likely to accentuate the spiral of indebtedness, as the final cost of the credit is often higher than that of the initial debts. When the MCD was transposed into French law by the Ordinance of 25 March 2016,[4] the legislator laid down important rules for credit consolidation. Arts L314- 10 ff. of the French Consumer Code govern this issue in a specific section. In the case of credit consolidation, the lender may request that the consolidation be accompanied by personal or real guarantees, in particular a mortgage. When credit consolidation involves only mortgage loans, or when the proportion of mortgage loans exceeds 60% of the amount being refinanced, Art. L314-11 of the French Consumer Code refers to the rules governing residential credit. Also, according to Art. L314-12 of the French Consumer Code, any credit consolidation operation secured by a mortgage or other comparable collateral on residential property or by a right attached to residential property is subject to the rules governing residential credit, whatever its purpose.

[1] Raymond (2021) § 11, 1-48.

[2] See https://www.service-public.fr/particuliers/vosdroits/F16140.

[3] *Cour de cassation* opinion, 20 June 1997, no. 09-70.006 P.

[4] Ordonnance no. 2016-351, 25 March 2016, sur les contrats de crédit aux consommateurs relatifs aux biens immobiliers à usage d'habitation.

2 Credit Agreements Not Subject to the MCD

In France, mortgage rules do not apply to all credit agreements for the acquisition of immovables.

2.1 Exclusion of Credit Agreements for the Acquisition of Business Property

Credit agreements for the acquisition of business premises are excluded from the provisions of the French Consumer Code. France has therefore not taken advantage of the transposition of the MCD, which concerns purchasers of residential property, to protect all borrowers taking out a mortgage loan. For the provisions stemming from the MCD to apply, credit agreements must relate to residential or mixed-use properties. However, it makes no difference how the property is occupied. It can be a primary residence, a second home or a rental investment.

2.2 Exclusion of 'Equity Release' or 'Prêt Viager Hypothécaire' from the Scope of the Provisions Relating to Residential Credit

According to Art. L315-1 of the French Consumer Code, inserted by the Ordinance of 23 March 2006,[5] a life mortgage ('prêt viager hypothécaire') is a contract by which a banking institution grants a natural person a loan secured by a mortgage on the borrower's residential immovable property, the repayment of which -principal and interest- may be demanded upon the borrower's death. This contract can only be entered into between a credit or financial institution on the one hand, and a natural person on the other.[6] Originating in Anglo-Saxon law, the life mortgage has so far had little appeal for elderly people seeking additional income. It is estimated that fewer than 1,000 life mortgages are taken out in France each year.[7]

This 'prêt viager hypothécaire' is governed by consumer law, which protects private individuals. Arts L315-1 ff. of the French Consumer Code apply. This body of rules is independent of those governing credit agreements for consumers relating to residential immovable property. Consequently, the rules transposing the MCD do not apply to these agreements. However, the consumer provisions applicable to 'prêt viager hypothécaire' are similar to those applicable to residential credit: commercial practices aimed at advertising such transactions are regulated, and an information system and formalities surround conclusion of the contract. For example, under Art. L315-4 of the French Consumer Code, which applies to 'prêt viager hypothécaire', all advertising made, received or perceived in France, regardless of the medium,

[5] Ordonnance no. 2006-346, 23 March 2006, relative aux sûretés, Art. 41.

[6] Art. L315-1 of the French Consumer Code.

[7] Randoux (2009) 2263 and 2401; Riffard (2018) 35.

concerning a life mortgage loan must be fair and informative. Art. L315-7 adds that the preliminary offer of credit must be distinct from any medium or document for advertising purposes. The form of the preliminary offer is strictly regulated. It is governed by the same rules as the residential mortgage loan offer, but the compulsory information is less and not so specific. Similarly, the penalties for failure by the bank to meet its obligations are less severe. The credit offer must be maintained for a minimum period of thirty days.[8] Acceptance of the offer can only take place ten days after the borrower has received it.[9] It is then recorded in a notarial deed.

2.3 Exclusion of Crowdfunding

In France, the use of crowdfunding to purchase immovable property is slowly gaining ground. On 8 February 8 2024, Mazars and the association *Financement Participatif France* published their 5th edition of the barometer of crowdfunding. Ten years after the promulgation of the Ordinance of 30 May 2014 regulating it, this form of financing has continued to expand. Today, immovable crowdfunding is worth 1.16 billion euros in France. It accounts for 55.6% of total funds raised. France had strongly regulated crowdfunding for the benefit of individuals, but this regulation was partly called into question by Regulation (EU) 2020/1503 of 7 October 2020 on European crowdfunding service providers for business.[10] Before this regulation came into force, loans that could be granted were limited to EUR 2,000 per project and per investor. Since the Regulation came into force, an alert is sent to non-professional customers, in the form of a warning, when they wish to make an investment exceeding EUR 1,000 or equivalent to 5% of their assets. Investors need only give their express consent to make the transaction possible.

Generally speaking, the entry into force of Regulation (EU) 2020/1503 has changed the face of crowdfunding as envisaged in France. Crowdfunding was conceived as a financing system based on the creation of a community, solidarity and sometimes disinterested donations. It belonged to what is known as the 'social and solidarity' economy. Under the influence of European Union law, it is now seen more as a genuine financial service. As a result, the transaction is distinct from mortgage credit and the provisions transposing the MCD do not apply to it.

2.4 Credit Agreements for Property Renovation, Particularly Energy Renovation

Under French law, for a credit agreement to finance building works to fall within the scope of the provisions transposing the MCD, two conditions must be met. The first

[8] Art. L315-10 of the French Consumer Code.

[9] Art. L315-11 of the French Consumer Code.

[10] Regulation (EU) 2020/1505 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937, OJ L 347/1, 20 October 2020.

condition relates to the purpose of the credit: the credit must be granted to finance the construction, repair, improvement or maintenance of a building. The second condition relates to the security for the credit agreement: the credit agreement must be secured by a mortgage or other comparable security (for example, under French law, the seller of a property benefits from a mortgage). As a result, when consumers borrow to carry out work on a building, particularly energy renovation work, a distinction must be made depending on whether or not the credit agreement is backed by a security comparable to a mortgage. In practice, it is common for the credit agreement to be accompanied by a mortgage, when the borrower takes out the loan for both the purchase of the property and its renovation. It is less common for the borrower to take out a mortgage on the property when the credit agreement is used solely to finance renovation work. In this case, consumer credit rules apply if the amount borrowed is less than or equal to EUR 75,000.[11] As a result, if the consumer borrows a sum in excess of EUR 75,000, without the loan being secured by a guarantee comparable to a mortgage, the borrower does not benefit from any special protection.

III Rules Applicable to the Formation of the Credit Agreement

1 Rules Relating to Pre-Contractual Information

1.1 A Special Case: Advertising for Rental Investments with a Tax Reduction

Specific provisions apply to advertising relating to the acquisition of residential property intended for rental and eligible for tax relief.[12] The content of the advertisement must make it possible to understand the risks associated with the investment and include a statement to the effect that failure to comply with the rental commitments will result in the loss of tax incentives. This statement must appear in a font size at least as large as that used to indicate any other information relating to the characteristics of the investment and must be included in the main body of the advertising text.

Failure to comply with these provisions may result in an administrative fine of up to EUR 100,000. The fine is imposed under the conditions set out in Chapter II of Title II of Book V of the French Consumer Code.

1.2 The European Standardised Information Sheet (ESIS)

Following the transposition of the MCD into French law, the creditor or credit intermediary must provide the borrower with personalised information in the form

[11] Art. L312-1 of the French Consumer Code.

[12] Art. L122-23 of the French Consumer Code.

of a European Standardised Information Sheet (ESIS), enabling the borrower to compare the various credit offers available on the market, assess their implications and decide whether or not to enter into a credit agreement. This ESIS must be provided at the latest when the credit offer is issued.[13] Art. R313-4 of the French Consumer Code sets out the list and content of the information to be included in the ESIS and the conditions for its presentation. All the information to be included in the ESIS is presented, on paper or on another durable medium, in the form of a single document with a clearly legible font. A model ESIS is appended to Art. R313-4 of the French Consumer Code.

Failure to comply with the conditions applicable to pre-contractual information is punishable by forfeiture of the right to interest, in the proportion set by the judge, up to an amount not exceeding 30% of the interest and is capped at EUR 30,000.[14]

The most notable case law concerning the ESIS relates to proof of delivery of this document. French judges have had to interpret French law in the light of European Union law regarding proof of delivery. As we know, the European Court of Justice (ECJ) has ruled that a clause in which the borrower acknowledges having received the ESIS in a pre-printed form is not sufficient in itself to prove that the lender has fulfilled its obligation to provide pre-contractual information. It can only constitute an indication that must be supplemented by other elements.[15] The French *Cour de cassation* adopted the same solution as the ECJ[16]. The French high court was followed by the lower courts.[17]

1.3 The Special Case of Credit Agreements Denominated in Foreign Currencies

French case law on foreign currency credit agreements is very extensive. It mainly concerns credit agreements denominated in Swiss francs. These credit agreements were marketed at the height of the subprime crisis, to compensate for the fact that variable interest rate loans were not attractive. It is estimated that around 6,000 French people took out a Swiss franc loan in 2008 and 2009.[18] These were residential credit agreements to finance purchases in France. The financial crisis of 2008 gave a

[13] Art. L313-7 of the French Consumer Code.

[14] Art. L341-25 of the French Consumer Code.

[15] ECJ 18 December 2014, *CA Consumer Finance SA*, C-449/13, EU:C:2014:2464; *Cour de cassation*, 1ère chambre civile, 5 June 2019, no.17-27.066; *Cour de cassation*, 1ère chambre civile, 8 April 2021, no. 19-20.890; *Cour de cassation*, 1ère chambre civile, 21 octobre 2020, no. 19-18.971.

[16] *Cour de cassation*, 1ère chambre civile, 8 April 2021, no. 19-20.890.

[17] See, recently, *Cour d'Appel d'Aix-en-Provence*, 5 July 2023, no. 22/09220.

[18] M. Bartnik, Le Figaro, 16 January 2015.

dramatic turn to these transactions. In less than 10 years, the Swiss franc appreciated by almost 45% against the euro in 2008. Borrowers then became aware of the risk created by such loans.

By delegation of the legislator, the government acted to tighten the regulations applicable to credit agreements denominated in foreign currencies within the Ordinance dated 25 March 2016 on consumer credit agreements relating to residential property. From then on, Arts L313-64 and R313-30 ff. of the Consumer Code will govern loans denominated in a currency other than the euro that are repayable in euros or in the currency concerned. In particular, a person may only take out such loans if he or she declares that his or her main income or assets are in the currency concerned at the time the loan contract is signed. However, this prohibition does not apply if the foreign exchange risk is not borne by the borrower. Furthermore, , the creditor must inform the borrower of the risks inherent in such a credit agreement and of any possibilities for converting repayments into euros during the course of the loan, at the latest when the loan offer is issued. However, as the provisions resulting from the Ordinance of 25 March 2016 on consumer credit agreements relating to residential property are not retrospective, a large number of disputes have been brought before the courts concerning loans concluded before the Ordinance of 25 March 2016 came into force.

Initially, the borrowers were unsuccessful before the *Cour de cassation*. Later, the French high court was obliged to comply with the case law of the ECJ on unfair terms. But it is still questionable whether French law complies with EU law in this point. In addition, the *Cour de cassation* refuses to recognise a duty to warn on the part of the creditor in the case of foreign currency loans.

In the field of unfair terms, after several unfavourable decisions to Swiss franc borrowers,[19] consumers have seen the trend reversed. In 2020, BNP Bank was found to be using misleading commercial practices.[20] But it was above all the ECJ's striking down BNP's marketing of the so-called 'Helvet'immo'[21] loans that led the *Cour de cassation* to change its case law. As is well known, contractual clauses establishing the operation of foreign currency loans relate to the subject matter of the contract and thus, in principle, they escape from unfairness controls, provided they are clear and comprehensible. The transparency of a clause means not only its formal clarity (its

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[19] *Cour de cassation*, 1ère chambre civile, 10 October 2019, no. 17-20.199; *Cour de cassation*, 1ère chambre civile, 13 March 2019, no. 17-23.169; *Cour de cassation*, 1ère chambre civile, 12 December 2018, no. 17-20.921.

[20] *Tribunal correctionnel de Paris*, 13ème chambre correctionnelle, 26 February 2020, no. 12290076010 ; Cattalano (2020) 90.

[21] ECJ 10 June 2021, *BNP Paribas Personal Finance*, C-609/19, EU:C:2021:469; ECJ 10 June 2021, *BNP Paribas Personal Finance,* C-776/19 C-782/19, EU:C:2021:470.

legibility from a grammatical point of view) but also its material clarity (the intelligibility of its concrete meaning and implications) for an average consumer. The ECJ suggested that the disputed clauses did not meet the requirements of transparency insofar as they made the borrower bear a foreign exchange risk that the consumer would not have accepted if the implications of the clause had been understood. Following this ECJ decision, the *Cour de cassation* reversed its position in two series of rulings in 2022.[22] However, the position of the French courts sometimes falls short of the requirements of EU law. For example, in a 2023 ruling, the *Cour de cassation* approved the lower courts' decision not to impose a transparency obligation on the creditor when the borrower's income was received in a foreign currency.[23] The ECJ has ruled that the average consumer must be provided with transparent information on the exchange rate risk to which he or she is exposed, so that the borrower can take this risk with full knowledge of the facts. Admittedly, the ECJ only ruled on cases where borrowers received their income in a currency other than the currency borrowed. But there is no reason to limit the obligation of transparency to this situation. The ECJ considers that, if the risk exists, the borrower must be informed of its existence, its extent and its concrete implications.[24] Indeed, in 2017, the ECJ stated that the professional must explain the possible variations in exchange rates and the risks inherent in taking out a loan in a foreign currency, particularly if the consumer does not receive his or her income in that currency.[25] Similarly, in 2018, the ECJ reiterated that the requirement of transparency in terms relating to the subject-matter of the contract implies that the lender must disclose the possible variations in exchange rates and the risks inherent in taking out a loan in a foreign currency.[26] The same is true of the 2021 decisions on Helvet'immo loans, in which the ECJ specified that the obligation of transparency is satisfied when the information provided makes it possible to understand the actual extent of the exchange rate risk taken throughout the term of the credit agreement.[27] The consumer must therefore be given specific information if a foreign exchange risk arises or increases during the term of the loan.

One question that has arisen in France in relation to foreign currency loans is whether the borrower can rely on the banker's duty to warn. Under French law, the duty to warn is an obligation on banks to inform borrowers of the existence of a risk. The *Cour de cassation* has decided to limit the duty to warn to the risk of indebtedness in

[22] *Cour de cassation*, 1ère chambre civile, 30 March 2022, appeal no.19-17.996; *Cour de cassation*, 1ère chambre civile, 20 April. 2022, no. 19-11.599: JurisData no. 2022-006342.

[23] *Cour de cassation*, chambre commerciale, 1 March 2023, no. 21-20.260.

[24] G. Cattalano (2023) act. 541.

[25] ECJ 20 September 2017, *Andriciuc*, C-186/16, EU:C:2017:703, para. 50.

[26] ECJ 20 September 2018, *OTP Bank y OTP Faktoring*, C-51/17, EU:C:2018:750, para. 75.

[27] ECJ 10 June 2021, *BNP Paribas Personal Finance*, C-609/19, EU:C:2021:469, para. 72.

relation to the borrower's financial capacity.[28] It refused to extend this duty to loans involving a foreign exchange risk.[29] Consequently, if the foreign exchange risk does not result in an excessive risk of indebtedness, the banker is not obliged to warn the borrower. It is regrettable that case law has refused to extend the duty to warn to the foreign exchange risk in the case of a loan in a foreign currency. Indeed, the exchange rate risk is very real in the case of such loans. But case law is unlikely to change. In fact, the government, when it intervened in 2016 to regulate loans denominated in foreign currencies, restricted the ability to take out such loans to people who receive their income or hold assets in that currency, but did not impose any particular duty of disclosure on lenders in such a case. If the government or the legislature have not thought it necessary to impose a duty to warn in the context of loans denominated in foreign currencies, it is unlikely that the courts will do so. In France, judges must apply the law, and their role as lawmakers is limited.

2 Creditworthiness Assessment and Deciding Whether to Grant the Loan

2.1 Setting Up Files to Check the Borrower's Creditworthiness

In France, there is currently a 'credit repayment incident file', also known as a 'negative file'. However, despite the political will to do so, a file to track the indebtedness of individuals, also known as a 'positive file', has not been set up.

The repayment incident file lists individuals who have failed to make two consecutive monthly payments. Natural persons who have undergone certain insolvency proceedings are also included. These are people who have found themselves unable to pay their debts and who have applied to a departmental over-indebtedness commission to have their debts deferred or cancelled.

Entries in this file may not exceed 5 years and, in the event of an error, the person concerned may request rectification from the bank that made the erroneous entry. This file is kept by the Banque de France and is consulted by banks when granting loans. However, while this file makes it possible to identify individuals who have not been able to pay off their debts, it does not contain any information about the loans individuals have taken out when they have paid off their debts. This is why the public authorities have taken steps to set up a positive credit file.

For several years now, there has been discussion in France about setting up a file to record the credit already granted to individuals. Legislative initiatives have been taken to set up such a file, but on each occasion, the legislator has abandoned the idea of creating a 'positive file'. It is likely that the debate on the adoption of a database of

[28] *Cour de cassation*, chambre mixte, 29 June 2007, no. 05-21.104, Bulletin civile, chambre mixte, no. 7.

[29] *Cour de cassation*, 1ère chambre civile, 3 May 2018, appeal no. 17-13.593.

personal loans will be revived when a new directive on mortgage credit is transposed into French law.

The purpose of a positive credit file would be to limit the granting of abusive credit, i.e. the possibility for individuals to borrow even though their financial situation may prevent them from meeting their repayment obligations. Indeed, the very fact of granting credit in this situation could constitute a fault likely to engage the responsibility of the lender. Admittedly, current case law does not support this view. However, judges have sometimes invoked the absence of a positive file, and consequently the lender's lack of knowledge of the borrower's real situation, to reject the lender's liability. This argument could no longer be put forward with the creation of such a file.

The fact that the bank is at fault should not entail relieving the borrower of all responsibility for repayment. However, it may be considered that the bank is at fault in granting a loan to someone who is already heavily in debt. Credit that is unbearable for the borrower does not become legitimate simply because the credit institution has informed the borrower of the risks of indebtedness. This is particularly true when various advertisements and other commercial solicitations have been used to induce the debtor to take out the loan. A form of 'shared responsibility' would give full meaning to the expression 'responsible credit' used by the legislature when it adopted the Consumer Credit Reform Act of 1 July 2010.[30]

The introduction of a database of loans granted to individuals has given rise to a wave of opposition in France, mainly from credit institutions represented by the French Banking Federation. For them, the introduction of a credit registry would be a disproportionate response to the issues at stake. This disproportionality would be all the more perceptible in that the effectiveness of a positive file in preventing over-indebtedness would be doubtful. It has been argued that the number of people on the register (around 25 million, according to estimates by the Banque de France) is disproportionate to the number of over-indebted consumers. In addition, setting up such a file would represent a significant cost and would be likely to infringe on people's right to privacy.

The Act of 1 July 2010 reforming consumer credit provided for a committee to prepare for the creation of a national register of consumer credit. The committee's task was not to decide whether or not such a register should be set up in France. Its task was to specify, in a highly operational manner, the characteristics that this file would have. The committee proposed that data relating to loans granted by credit institutions to consumers should be included in this file. This would have covered both mortgages and consumer credit. The committee proposed an aggregated return of the data recorded. The credit institution consulting the file would only be able to obtain

[30] Loi no. 2010-737 of 1 July 2010, portant réforme du crédit à la consommation.

aggregated information for all the loans taken out and not data specific to each loan. This procedure was intended to prevent the information recorded from being used for commercial purposes. The credit institution would only have had access to a 'score', drawn up on the basis of aggregated data relating to the individual.

When the Consumer Act of 17 March 2014 was passed, a law that includes significant advances in consumer protection, the legislator once again proposed the creation of a positive file. However, under this proposal, banking institutions did not just have access to a 'score'. They could also find out how much debt an individual had. The Constitutional Council censured the creation of such a file, ruling that it infringed the right to privacy and could not be considered proportionate to the aim pursued.[31] In fact, this is the main provision of this law that was censured by the Constitutional Council. Although there is still strong opposition, it is likely that the debate on the introduction in France of a database of personal loans will resume.

2.2 The Challenges Posed by Digitisation: The Role of AI During the Contractual Process and in Particular Concerning the Creditworthiness Assessment

According to a study carried out in 2017, the banking sector is one of the sectors in which artificial intelligence is most widely used. Expert systems (or decision support tools) are one of the most mature and proven forms of artificial intelligence. According to this study, 88% of banks use expert systems (or decision support tools).[32] Mainly used for granting credit, they are capable of simulating the behaviour of a human expert and analysing the risk of granting credit to individuals, professionals or businesses.

Another tool used by banks to determine credit risk is credit scoring. It differs from the expert system in that it is based on statistical analyses of a sample of data. Discriminating criteria are determined (amount of income, age of borrower, etc.), and a score (number of points obtained) is calculated as a function of the risk. To use credit scoring, it is important to have a history and a large volume of applications, including applications that have been rejected (not processed) at the time of appraisal. Credit scoring makes a prediction based on a sample of files, whereas the expert system considers the business rules system. The amount of data and the risk criteria analysed are greater in a rules-based system than in credit scoring. For example, an expert system integrates banking regulations into its analysis, which credit scoring does not. Expert systems sometimes include scores in the risk analysis. For example, a behavioural score, such as account analysis, can be integrated into an expert system. In this way, the decision of the decision-making tool will take into account the score

[31] Décision du Conseil Constitutionnel no. 2014-690, 13 March 2014, esp. no. 57.

[32] Blanc (2017) 34.

and will be completed by the rules governing the business.[33] It's a way of reinforcing the decision.

Although French banks use artificial intelligence to determine whether or not to grant a mortgage, to our knowledge, this use of artificial intelligence has not been the subject of any regulations of its own.[34] On the other hand, regulations relating to other areas, such as personal data protection, do of course apply to the use of artificial intelligence. In France, an independent administrative authority, the *Commission Nationale Informatique et Libertés* (CNIL), is responsible for monitoring the proper application of the provisions relating to the protection of personal data, like GDPR, by credit institutions and for penalising them in the event of any breach of these provisions.

In principle, automated processing of personal data must be declared to the CNIL. This should therefore be the case for files containing information on the assets of private individuals. However, in a decision dated 8 July 1980,[35] the CNIL held that credit institutions could benefit from a simplified standard for files the purpose of which is to 'compile and study credit or loan applications'. This standard specifies the information that may be collected, such as the economic and financial situation of the borrower, the length of time this information is kept and the list of possible recipients. As a result of this decision, credit institutions need only make a declaration of compliance with this simplified standard for their files to be considered as not entailing any risk of infringement of privacy and freedoms.

A CNIL authorisation, and not just a declaration, is required when the automated processing of data is likely, by its nature, scope or purpose, to exclude individuals from the benefits of a contract. For example, because it may lead to a loan being refused, the processing of decision-support data based on score models must be authorised by the CNIL. But here again, in a decision dated 2 February 2006,[36] the CNIL adopted a decision that, if complied with, amounts to authorisation. In this text, the commission specifies what personal data can be considered to calculate the score. These include the borrower's assets.[37] Credit institutions may simply send the CNIL commitment to compliance with the obligations set by the authorisation decision in order to set up processing of decision-support data.

[33] Prologia, Crédit : Quelle place pour l'intelligence artificielle ? Blog.

[34] At the European Level, see Regulation (EU) 2024/1689 of the European Parliament and of the Council of 13 June 2024 laying down harmonised rules on artificial intelligence, OJ L, 12 July 2024.

[35] Délibération de la CNIL 80-23, 8 July 1980.

[36] Délibération de la CNIL 2006-019, 2 February 2006.

[37] Art. 2 Délibération de la CNIL 2006-019, 2 February 2006.

2.3 A Novelty in France: The Recent Adoption of a 'Second Chan' Scheme

In response to the difficulties that individuals are currently experiencing in obtaining a home loan, French banks, under the aegis of the French Banking Federation, have recently introduced a 'system for reviewing unapproved home loans'.[38] The aim of the scheme is to allow a second review of a loan application that has been rejected at the initial stage. More specifically, it is aimed at individuals who are customers of the concerned bank and who submit a compliant that allows the bank to carry out a full review of the loan application. These individuals must not be registered in the credit repayment incident file managed by the Banque de France.[39] The applications must relate to the financing of the borrower's principal residence, a second home or a rental investment, all of which meet the criteria laid down by the High Council for Financial Stability; the duration of the loan and affordability must be calculated using the bank's lending terms and conditions.[40] The aim of this procedure is to ensure that credit agreement applicants understand the reasons for their bank's decision and, if the conditions are met, benefit from a re-examination of their loan application. Banks began phasing in this system at the beginning of 2024. It is up to each bank to determine how it organises and informs its customers. However, people wishing to buy a property have no 'right to credit'. The banker retains the right to grant or refuse credit. This solution is regularly reiterated by French case law.[41]

IV Creation of Links Between the Loan Agreement and the Sale of Immovable Property

1 Creation of an Arm's Length Relationship Between the Sale of the Property and the Loan Agreement

In the mind of the consumer, the credit agreement and the planned purchase of the property form an indissociable whole. For years, French notarial practice linked the two transactions by means of a condition that renders them interdependent. It was therefore necessary for this link to be expressly included in the contract. However, in 1979, the legislator introduced an interdependence between the property transaction

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[38]Fédération bancaire française, communiqué, 1 January 2024; J. Lasserre-Capdeville (2024) 215; E. Gueugneau, 'Prêt immobilier: les banques vont réexaminer les dossiers recalés'. Available at: https://www.lesechos.fr/finance-marches/banque-assurances/credit-immobilier-les-banques-vont-reexaminer-les-dossiers-recales-2073203.

[39] For more on this file, see II 2.1.

[40] According to the criteria laid down by the High Council for Financial Stability, in principle, the cost of credit (repayment of capital, interest and insurance) must not exceed 35% of the borrower's income.

[41] See for example, *Cour de cassation*, Assemblée plénière, 9 October 2006, no. 06-11.056. A. Viander (2006) 2618; Lasserre Capdeville (2019) 99-103.

and the loan agreement. Today, Art. L. 313-41 of the French Consumer Code states that when the deed of purchase indicates that the price will be paid by one or more loans, the main deed will be concluded subject to the suspensive condition of obtaining the credit agreement or credit agreements. For this mechanism to apply, the promise to sell the property must mention the borrower's intention to take out a loan to pay for the planned transaction.[42] The sale is therefore necessarily subject to the suspensive condition of obtaining a loan. In an opinion, the *Cour de cassation* stated that it was not necessary for the deed to mention the interest rate of the planned loan, its repayment period or the maximum amount of the monthly instalments,[43] but in practice this is almost always mentioned.

If the deed indicates that the price will be paid without a loan, the deed must contain a statement in the purchaser's handwriting acknowledging that he or she has been informed that if a loan is taken out in the end, the suspensive condition cannot be invoked.[44]

The agreement concluded subject to the suspensive condition of obtaining a loan must specify the closing date. Before this date, the consumer will be able to seek the required financing. This period begins on the day the agreement is signed.

There is no problem if the consumer obtains and accepts the loan within the agreed period. However, one of the biggest criticisms that this mechanism raises is that it its extremely easy for the purchaser to ensure that the condition will not be met, thus allowing the purchaser to withdraw from his or her main commitment under the contract (i.e. to pay the price).. Many disputes have revolved around this issue. Borrowers claim to have taken the necessary steps and are demanding the return of any deposits or earnest money paid, whilst the vendors seek to retain the sums already paid by the buyer at the time of the promise to purchase. They often claim that the borrowers did not try hard enough or that they made mistakes, or even that they did not accept an offer that complied with the conditions stipulated in the main contract. Case law has tried to reconcile the need for consumer protection with contractual loyalty. The borrower must diligently fulfil the obligation to apply for the credit agreement provided for in the main contract. It is up to the consumer to prove that he or she has actually applied for a loan that complies with the characteristics set out in the preliminary contract.[45] The borrower is deemed to have taken sufficient care if

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[42] Art. L313-40 of the French Consumer Code.

[43] Avis de la Cour de Cassation, 18 May 1998, no. 98-00.003, Bulletin civil, no. 7.

[44] Art. L313-42 of the French Consumer Code.

[45] *Cour de cassation*, 1ère chambre civile, 9 February 1999, no. 97-10.195. Observation J.L. Aubert (1999) 755; *Cour de cassation*, 3ème chambre civile, 30 January 2008. Observation G. Forest (2008) 545.

a loan that complies with the stipulations in the preliminary contract has been applied for.[46]

If the loan is not obtained, the person who intended to buy the property is no longer bound by the agreement. Any sums paid in advance by the purchaser to the other party must be reimbursed, without deduction or compensation of any kind.[47] The aim of this provision is to ensure that the consumer who has not obtained the loan is not penalised financially. For this reason, the scope of this provision is fairly broad. Case law has ruled that advance fees paid to an architect should be reimbursed, insofar as they were included in the overall estimate of the construction price of a detached house.[48]

Failure by the vendor to comply with the obligation to reimburse the amounts paid is subject to criminal and civil penalties. In particular, the seller will be liable to a fine of EUR 300,000.

2 The Borrower Can Withdraw From the Credit Agreement if the Contract for the Sale of the Property No Longer Exists

In French law, under the ordinary law governing loans, there is independence between the financing contract and the financed contract. As a result, even if the main contract disappears, the loan survives, at least in principle. In order to protect the consumer, the opposite principle applies to home credit agreements. Art. L313-36 of the Consumer Code states that the loan offer is always accepted subject to the resolutory condition that the transaction for which the loan is requested is not concluded within four months of acceptance. The parties always have the option of stipulating a longer period. In this way, the borrower does not run the risk of remaining bound by the loan, even though it is no longer in a position to conclude the contract for the planned purchase of the property.

V Rules Applicable During the Term of the Credit Agreement

Various rules have been adopted to ensure that the borrower is not a 'prisoner' of the banking institution during the term of the credit agreement. These provisions do not result from the transposition of the MCD, but from the French government's desire to reduce the cost of credit for consumers, by limiting their dependence on banks and promoting competition between banking establishments. The objectives of protecting

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[46] *Cour de cassation*, 3ème chambre civile, 8 December 1999, no. 98-10.766. Observation D. Mazeaud (2000) 245.

[47] Art. L313-41 of the French Consumer Code.

[48] *Cour de cassation*, 1ère chambre civile, 3 January 1996, no. 93-19.128, Bull. civ. I, no. 10.

consumer interests and reducing distortions of competition are also very much in evidence in European Union law. Consequently, provisions similar to these French ones could be adopted in the new MCD directive.

1 The Bank Can No Longer Link the Loan to the Borrower's Insurance

In the event of a borrower's physical injury or unemployment, payment protection insurance guarantees that the borrower's debt to the lender will be paid. The cost of this insurance, a compulsory contract for taking out a home loan, is often substantial. However, in most cases, borrowers do not take advantage of the competition but choose the policy offered by the bank from which they are borrowing. For a long time, banks made the granting of a loan conditional on taking out insurance with an insurer that they themselves chose, usually within the bank-insurance group to which they belonged. What's more, such insurance policies were taken out for the duration of the loan, sometimes for 15, 20 or 25 years. This practice turned borrowers into ‘captive policyholders’. To put an end to this practice, the French legislature intervened on several occasions. Initially, Act no. 2010-737 of 1 July 2010[49] made it possible for borrowers to choose a different insurance provider before taking out a mortgage loan. Through the mechanism of insurance delegation, and provided that the guarantees offered were sufficient in the eyes of the lender, borrowers could be covered by any insurer. This meant that lending banks could no longer systematically impose their choice of insurer. Law no. 2014-344 of 17 March 2014[50] then authorised borrowers to change their insurance at any time within 12 months of taking out the loan. While the *Cour de cassation* was still refusing to allow insurance contracts to be cancelled (even by the courts) if a clause did not allow this, Art. 10 of Law no. 2017-203 of 21 February 2017[51] introduced an annual cancellation option. Art. L113-12-2 of the Insurance Code was then amended. Since the law of 28 February 2022,[52] for the entire duration of the guaranteed loan, and regardless of the date on which the loan was taken out, policyholders may change insurers at any time they see fit.

[49] Loi no. 2010-737 of 1st July 2010, portant réforme du crédit à la consommation. See Cannarsa (2011) 9.

[50] Loi no. 2014-344 of 17 March 2014.

[51] Loi no. 2017-203 of 21 February 2017, ratifiant les ordonnances numéros 2016-301 du 14 mars 2016, relative à la partie législative du Code de la Consommation, et 2016-351, 25 March 2016, sur les contrats de crédit aux consommateurs relatifs aux biens immobiliers à usage d'habitation et simplifiant le dispositif de mise en œuvre des obligations en matière de conformité et de sécurité des produits et services.

[52] Loi no. 2022-270 of 28 February 2022 pour un accès plus juste, plus simple et plus transparent au marché de l’assurance emprunteur.

2 Renegotiating a Credit Agreement

The fall in interest rates in France in recent years has led to a large number of renegotiations. Borrowers have been renegotiating for lower interest rates than those applied when they took out the loan.

The former Art. L312-8 of the French Consumer Code stipulated that any changes to the terms and conditions of a loan, in particular the amount or the interest rate of the credit, had to be accompanied by a new offer. Case law had deduced from this that it was necessary to submit a new preliminary offer in the event of renegotiation of a property loan.[53] This solution was not necessary, as renegotiation is always in the exclusive interest of the borrower. The borrower is unlikely to agree to a worsening of his or her situation during the term of the contract. This is why French law was reformed in this respect by the Savings and Financial Security Act of 25 June 1999.[54] This law introduced a new Article into the Consumer Code, which stipulates that, in the event of loan renegotiation, changes to the initial loan contract are to be made solely in the form of an amendment drawn up on paper or on another durable medium.[55]

3 Early Repayment

Even in the absence of a contractual clause, borrowers have the right to repay their loan early.[56] This legal right overrides any clause to the contrary that the lender may have imposed when negotiating the loan. An indemnity for early repayment may be validly stipulated in home loan contracts. Here again, to ensure that consumers are not 'prisoners of their loan contract', the amount of this indemnity is subject to two caps. The amount of this indemnity may not exceed the value of half a year's interest on the principal repaid at the average rate for the loan. Nor may it exceed 3% of the capital outstanding before repayment.[57] The borrower will therefore be able to repay the loan early, paying no more than 103% of the outstanding principal.

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[53] *Cour de cassation*, 1ère chambre civile, 6 January 1998, no. 95-21.880.

[54] Loi no. 99-532 of 25 June 1999 relative à l'épargne et à la sécurité financière.

[55] Art. L313-29 of the French Consumer Code.

[56] Art. L313-47 of the French Consumer Code.

[57] Art. R313-25 of the French Consumer Code.

VI Conclusion

The contributions made by French law to protect consumers in relation to the provisions of the MCD mainly concern the contract performance phase. These contributions are mainly the work of the legislator. The *Cour de cassation* is very cautious about implementing real consumer protection in credit matters.

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CHAPTER 4

THE MORTGAGE CREDIT DIRECTIVE UNDER REVIEW: VIEWS FROM GREECE

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I General Introduction

It has been almost eight years since the entry into force of Law 4438/2016[1] (Transposing Law), which implemented the MCD.[2] The Transposing Law created a sound, detailed and more structured institutional and legal framework for the contractual practice and the judicial protection of the residential housing borrowers in Greece. In the following, an effort is made at identifying the actual impact of this enhanced set of legal rules in Greek transactional practice.

In the time since the promulgation of the Transposing Law, the financial climate and the housing market landscape in Greece have drastically changed. The economy has bounced back from deep recession to relative normality, considering global challenges

[1] Law 4438/2016 on the transposition of the MCD, Government Gazette Issue (GGI) A' 220/28 November 2016, as amended.

[2] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, OJ 2014 L 60, 28 February 2014, 34–85.

such as the aftermath of the Covid19 pandemic, the conflicts in the Ukraine and the Middle East and the unusually high inflationary pressures. It should be noted that this improvement of the macroeconomic indicators of the Greek economy as a whole is not yet equally reflected on the microeconomic level and the financial conditions of the average inhabitant of Greece. Even so, the economic environment is much better and more amenable to investments in residential housing than it was in 2016 and throughout the financial crisis that hit Greece from 2010 onwards. Another interesting remark in this regard: although the residential housing market is on the rise, the bank credits granted for this purpose are rather low and they do not correspond to the current rise in residential housing transactions.

Legal doctrine in Greece addressed several issues of the Transposing Law and it tried to interpret it systematically, to integrate it into the Greek legal system and to align its application with existing rules of both national and European origin. A field of particular concern for Greek legal theory consists in the specific legal consequences of the non-observance of the Transposing Law in the relation between lender and borrower, since the MCD relegates the relevant prerogative to the Member States[3] and the Transposing Law rather focuses on administrative sanctions against the violating creditors and less on the contractual implications per se of its violation within the loan agreement and the mortgage securing it. Perhaps surprisingly, the interest shown by Greek legal doctrine in the Transposing Law is not matched by court practice in Greece, at least based on the reported case law. Possible reasons for this discrepancy are expounded on further below.

The present report aims at taking stock of the legislative, judicial and transactional evolution of the Transposing Law since its promulgation and at assessing its impact on the Greek mortgage market. In the following, the discussion that the Transposing Law has elicited over the past few years is reviewed and summarised and an effort is made at tracing the current footprint of the Transposing Law in Greek banking and transactional practice.

II Landscape of Residential Housing Market since 2017

The prices of land, especially residential properties, in Greece feature a trend of steady increase over the past few years, although they still have not reached the pre-crisis peak levels of 2008. During 2023, the average nominal price of apartments rose by 13.4% (compared to 11.9% in 2022); the stronger increases were noted in major urban centres, such as Athens and Thessaloniki. The Bank of Greece is 'cautiously positive' in its assessment of the prospects of the Greek residential market, considering the inflationary pressures, the current geopolitical instability and the resulting uncertainties, but the current trend is expected to continue. At the same time, housing cost increasingly becomes in recent years a pressing matter for many Greek

[3] See Arts 38-39 MCD and its Recital 76.

households due to a variety of factors, such as the ever-growing exploitation of housing for investment or business purposes (mostly AirBnB rentals), the low activity over many years in the construction sector, which hindered the replenishment of the housing stock, and the withdrawal from the market of properties securing non-performing loans and which have been earmarked for auction.[4]

International financial institutions have expressed deviating views on the growth trends of the Greek housing market: the European Systemic Risk Board notes the continuous expansion of the Greek housing market but expresses concern that price levels in this market remain undervalued,[5] whereas the International Monetary Fund in a recent report on the Greek economy detected emerging imbalances in the Greek property market and qualified the rapid increase in prices as a still nascent but potentially important systemic risk.[6]

At the same time, the housing credit market in Greece is not growing in tandem with the increase in property transactions. The open balances of housing credits in Greece have been steadily declining since 2022, the average housing credit falls short of €70,000 and more than half of the borrowers opt for a fixed interest rate for periods of more than ten years.[7] The available data indicate in clear terms the risk-averse and conservative behaviour of the great majority of borrowers for residential housing. Consequently, the housing market is still a long way from reaching the pre-crisis levels in Greece.[8]

[4] Bank of Greece, Report on financial stability (April 2024), 23-6. Available at: https://www.bankofgreece.gr/Publications/FINANCIAL_STABILITY_REVIEW_APRIL_2024_EL.pdf

[5] European Systemic Risk Board, Follow-up report on vulnerabilities in the residential real estate sectors of the EEA countries, February 2024, 46. Available at: https://www.esrb.europa.eu/pub/pdf/reports/esrb.report.vulnerabilitiesresidentialrealestatesectors202402~df77b00f9a.en.pdf?d862a6be57d42a021d79e3e16cfd305b

[6] International Monetary Fund, Greece – Selected Issues (IMF Country Report No. 24/24), January 2024, 18. Available at https://www.imf.org/-/media/Files/Publications/CR/2024/English/1GRCEA2024002.ashx

[7] Bank of Greece (2024) 27-30.

[8] Malliara, 'Anemic' housing credit market («Αναιμία» στη στεγαστική πίστη)", Insider web portal, 29 April 2024. Available at: https://www.insider.gr/epiheiriseis/318677/anaimia-sti-stegastiki-pisti-epese-se-eu687-hil-meso-daneio-stathero-epitokio

III Legislative Changes in the Transposing Law since its Promulgation

1 Amendments to the Transposing Law since its Promulgation

Over the course of the past years the Transposing Law has been amended a couple of times, in most cases in order to reflect legislative changes at the EU level. The changes in question concerned the following provisions:

a) Art. 12 ε) (Art. 13 MCD) was amended in 2018 to extend the duty of credit institutions and credit brokers to inform the borrower on the available interest rates, with special reference to indexed interest rates, pursuant to Regulation (EU) 2016/2011.[9]

b) In late 2023, a series of amendments were introduced to the Transposing Law[10] in order to harmonise it with the Directive 2021/2167/EU, which in its turn amended certain provisions of the MCD:[11]

A new Art. 26(A) (Art. 27(a) MCD) was introduced, regulating in detail the information duties of the credit institution to the borrower prior to changes in the terms and conditions of the credit agreement. The relevant information duties cover both the content and process of the changes and information about the competent authorities to which the borrower may resort in case of disputes.

Art. 27(1) (Art. 28(1) MCD) was amended to reflect the enhanced requirement of 'reasonable forbearance' (*εύλογη ανοχή*) which the MCD now regulates in more detail (while leaving substantial leeway to the Member States) with a view to encouraging credit institutions to settle disputes with borrowers in arrears amicably prior to initiating enforcement proceedings. The new provision requires credit institutions to comply in this regard with the Deontology Code of Greek Banks[12] and to establish appropriate policies and procedures in respect of settlement options that can be

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[9] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No. 596/2014, OJ L 171, 29 June 2016, 1–65.

[10] See Arts 35-37 Law 5072/2023, GGI A' 198/4 December 2023.

[11] Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU, OJ L 438, 8 December 2021, 1-37.

[12] Act of the Governor of the Bank of Greece 392/31.5.2021 on the revision of the Deontology Code of Greek Banks, GGI B' 2376/7 June 2021. For a brief account of the Deontology Code of Greek Banks and the legal framework previously in force, see Moraitis (2017) 241, Fn. 15.

implemented prior to mortgage enforcement. The exercise of reasonable forbearance shall depend on the case and the individual circumstances of the borrower in question, among other parameters.

A new Art. 27(A) (Art. 28(a) MCD) was introduced with a view to reinforcing the borrower's position in case the credit institution assigns its claims against the borrower to a third party. In such a case, the borrowers may plead against such third party any defences that they had against the original creditor, including the right to set off if the legal requirements for set-off are at hand (Art. 27(A)(1)). In addition, the borrower has to be informed about such assignment, unless the original creditor agrees with the assignee to continue servicing the credit (Art. 27(A)(2)).

The rule of Art. 27(A)(1) Transposing Law is in line with the general Greek-law rules on assignment of claims and does not add to the protection that the borrower would anyway enjoy in such a case under the provisions of the Greek Civil Code (*Αστικός Κώδικας*, AK).[13]

The provision of Art. 27(A)(2), on the contrary, slightly deviates from the relevant rule of Art. 460 AK, which provides that an assignment is effective vis-à-vis the debtor only after the assignment has been notified to the debtor by the assignor or the assignee. Accordingly, Art. 27(A)(2), which dispenses with the notice to the debtor if the assignor / original creditor continues to service the credit, seems to be lowering the protection standard – as compared to general Greek civil law – for the borrower; in fact, in spite of the declared intention of the EU legislator to ensure that the borrower is not worse off in such constellations.[14] The question that logically follows is whether any disadvantage arises for the debtor out of this provision and, if yes, what such a disadvantage is and how it can be quantified. The issue is not apt for generalisation and shall depend on the circumstances of each particular case (e.g. if the assignee is based abroad, which could eventually create additional hurdles in case of court proceedings, etc.), but it can reasonably be argued that a borrower has a legitimate interest to know at all times who the creditor is.

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[13] Cf. 463 AK, which inter alia allows for the debtor to set off against the assignee a counterclaim that the debtor had against the assignor at the time of notice of assignment even if such counterclaim is not due yet (but becomes due before the assigned claim). See Georgiades (2015) § 42 nos. 65-8; Filios (2011) § 76 Δ. II. β), § 101 B; Stathopoulos (2018) § 27 no. 60-1; Spyridakis (2018) no. 245.4. To place this rule in context and understand its exceptional character, one has to keep in mind that, under the general Greek law of set-off, the counterclaim of the person proposing the set-off must be due, even if the principal claim, i.e. the claim of which this person is the debtor, is not due yet; see, e.g., Stathopoulos (2018) § 24 nos. 39-40.

[14] See Directive (EU) 2021/2167, Recital 52: 'As a general principle, it should be ensured that borrowers are not worse off following the transfer of their credit agreement from a credit institution to a credit purchaser.'

2 The Concept of 'Reasonable Forbearance' in Particular and its Legislative Configuration

The requirement of 'reasonable forbearance' (*εύλογη ανοχή*), as specified in further detail with Directive (EU) 2021/2167 and transposed in Greece with law 5072/2023 relies upon the explicit intention of the EU legislator to ensure an element of leniency in the treatment of residential borrowers in arrears, taking into account their individual conditions and social circumstances, their rights and interests as consumers and their ability to repay the loan, as well as the question whether the residential property securing the loan in arrears is the borrower's principal residence or not. It is expected that certain concessions to the borrower shall be made possible, including refinancing options and modifications of the credit terms in force, such as an extension of payment term, change in the credit type, etc.[15]

The notion of reasonable forbearance is not entirely new in Greek legal thinking. Already back in 2012, legal doctrine had suggested a concept for the so-called 'over-indebting agreement', which essentially relied upon similar considerations of forbearance towards a debtor who is not in position to fulfil their contractual obligations, usually due to a severe change in circumstances after the conclusion of the agreement in question. This proposition was coupled with the doctrinal exploration of a number of potential remedies derived from general Greek civil law, which all aim at addressing the excessively onerous position in which debtors find themselves and at re-establishing their financial freedom and right to self-determination.[16]

In the Recitals to Directive (EU) 2021/2167 specific reference is made, for the purposes of this new requirement, to the European Banking Authority (EBA) Guidelines on arrears and foreclosure of 19 August 2015[17] and on management of non-performing and forborne exposures of 31 October 2018,[18] as well as the European Central Bank (ECB) Guidance to banks on non-performing loans of March 2017.[19] In fact, the

[15] See Directive (EU) 2021/2167, Recital 56.

[16] See for more details, Mentis (2012) no. 44.

[17] EBA, Guidelines on arrears and foreclosure of 28 June 2024. Available at: https://www.eba.europa.eu/legacy/regulation-and-policy/regulatory-activities/consumer-protection-and-financial-innovation-6 (the document was last amended on 28 June 2024).

[18] EBA, Guidelines on management of non-performing and forborne exposures of 31 October 2018. Available at: https://www.eba.europa.eu/activities/single-rulebook/regulatory-activities/credit-risk/guidelines-management-non-performing

[19] ECB, Guidance to banks on non-performing loans of March 2017. Available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf; see also, Addendum to the ECB Guidance to banks on non-performing loans: supervisory expectations for prudential provisioning of non-performing exposures. Available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.npl_addendum_201803.en.pdf

Recitals go beyond the scope of the legislative changes introduced with the Directive, since Member States are encouraged to ensure 'minimum living conditions' for a borrower whose debt remains outstanding following enforcement, and to implement measures that render debt repayment possible and avert long-term over-indebtedness.[20]

The 'travaux préparatoires' of the law 5072/2023 do not reiterate or otherwise make direct reference to the recitals of Directive (EU) 2021/2167, but they are reflected in the revised Art. 27(1) of the Transposing Law. The new provision did not take over one-to-one the relevant wording of Art. 28 of Directive (EU) 2021/2167, which lists a number of instances showcasing reasonable forbearance, but it refers instead to the Deontology Code of Greek Banks and requires that the Greek credit institutions consider and adopt appropriate dispute settlement policies and procedures before resorting to enforcement proceedings against borrowers in arrears. The dispute settlement policies and procedures should take into account, in particular, the consumer's personal circumstances, as well as the dispute resolution mechanisms listed in Annex II of the Act of the Governor of the Bank of Greece No. 392/1/31.5.2021.

The dispute resolution mechanisms referenced to in the new Art. 27(1) Transposing Law are not exhaustive; they include a large array of debt adjustment and dispute resolution options, and they aim at a minimum standardisation of widely used rules and procedures for this purpose. The declared purpose of the Bank of Greece in suggesting the dispute resolution mechanisms in question was to achieve better comparability, transparency and effectiveness tracking, both for the credit institutions subject to the supervision of the Bank of Greece and in the Greek banking system as a whole.[21] The remedies in question feature a wide range, roughly equivalent to the list of Art. 28 of Directive (EU) 2021/2167:

a) Short-term arrangements (i.e. solutions aimed to last for no longer than two years), such as arrears capitalisation, repayment plans, various configurations for the allocation of each loan repayment made by the debtor to interest and capital of the loan, and grace periods.

b) Long-term arrangements (i.e. arrangements designed to last for more than two years), such as interest rate reduction, loan term extension, split balance in serviceable

[20] See Directive (EU) 2021/2167, Recital 56. The EU legislator goes on to recommend certain 'prudential' duties of behaviour on the credit institutions, such as obtaining 'best efforts price' for foreclosed residential immovable property, and to express its preference that transfer of the security (residential property serving as collateral) should be sufficient in order to repay the debt in full (*datio ad solutum*).

[21] See Act of the Governor of the Bank of Greece No 392/1/31.5.2021, Annex II, Preamble.

part of the loan and part to be repaid through enforcement measures, partial debt write-down, etc.

c) Permanent resolution arrangements, i.e. changes in the nature of the contractual relationship between credit institution and borrower or even its termination, which may or may not be combined with the (voluntary) transfer of the residential property serving as collateral to the creditor (*datio in solutum*) or its forced sale and the use of the proceeds for debt repayment. Such arrangements include various out-of-court settlements, voluntary surrender of mortgaged property (which may be combined with a lease-back to the borrower), voluntary sale of property (whereby the creditor may write off the rest of the debt, if the proceeds fall short of the actual debt amount), etc.

The examples listed reflect international best practices, but it is noted that their implementation in Greece is in all cases subject to observance of the relevant domestic legal requirements and provisions.

Not all measures included in Annex II of the Act of the Governor of the Bank of Greece No. 392/1/31.5.2021 are suitable for consumers, since some pertain specifically to enterprises as debtors (e.g. operational restructuring or debt/equity swaps). However, the options mentioned above serve to indicate the type of measures that the legislator seeks to integrate into the MCD in respect of the treatment of payment arrears and their consequences. The amendment to the MCD pursued with Art. 28 of Directive (EU) 2021/2167 is indicative of increased concern in respect of non-performing loans, even more so in the context of housing consumer credit, which understandably has more far-reaching social consequences than other forms of consumer debt.

IV Transposing Law Issues in the Course of Its Implementation

Shortly after promulgation of the Transposing Law, legal doctrine in Greece took issue with two matters in particular: its *ratione temporis* scope of application and the civil-law implications in case of violation of its provisions.[22]

1 The *Ratione Temporis* Scope of Application of the Transposing Law

Art. 42(1) MCD required that the MCD be transposed into the national laws of the EU Member States by 21 March 2016. However, the Transposing Law entered into force, as per its explicit provision in Art. 62, on 28 November 2016, namely more than 8 months after the deadline prescribed in the MCD.[23] In addition, the Transposing Law

[22] See, in detail, Tzakas (2018) 1000-1012 *passim*.

[23] The first draft of the Transposing Law provided that, once passed, it would retroact to 21 March 2016; however, this provision was later amended and the Transposing Law entered into force as of the date

did not contain any transitional provisions aiming at the alignment of its implementation in Greek law with the MCD requirements.

In addition to art 42(1), Art. 43(1) MCD precluded its applicability to credit agreements already concluded ('existing') prior to the entry into force of the MCD, while Art. 23(5) MCD allowed Member States to adopt further statutory rules (beyond those provided in the MCD) on foreign currency loans though not with a retrospective effect. These provisions taken together are a clear indication that the European legislator had a precisely delineated concept in mind in respect of the temporal scope of application of the MCD in the Member States.

Although one could suggest that the delay by the Greek legislator to transpose the MCD could be remedied either by way of interpretation of Greek law in accordance with EU law or by resorting to the general clauses of the AK on good faith and transactional mores (Arts 281, 200 and 288 AK),[24] both options are rejected by legal doctrine. Therefore, to the extent that borrowers may have incurred damages due to the delayed transposition of the MCD into the Greek legal system, it has been proposed that such damages could eventually lead to civil liability of the Greek state, provided that all requirements of such liability are met.[25] In particular, there are no sufficient grounds in law to infer that the elaborate obligations imposed by the MCD and the Transposing Law on credit institutions and credit brokers could be deemed to be mandatory prior to the promulgation of the latter – also in view of the restricted effect of EU directives in the national law of the Member States prior to their transposition.[26] To date, the proposal on the potential civil liability of the Greek state for the belated transposition of the MCD does not appear to have been tested before the Greek courts.

of its publication in the Government Gazette (except as otherwise provided in it). At the same time, the first draft did provide in Art. 40(1) that it would not apply to credit agreements validly concluded prior to 21 March 2016, but this provision was eventually removed from the Transposing Law. The reasons for this change are not entirely clear; for a brief account of the treatment of the *ratione temporis* scope of the Transposition Act during its promulgation, see Moraitis (2017) 250-1.

[24] For the general clauses in question, especially Art. 288 AK, see Stathopoulos (2018) § 5; Georgiades (2019) § 2 nos. 19-20, § 7 nos. 45-46; Spyridakis (2022) no. 13; Georgiades (2015) § 2 nos. 31-38; Filios (2011) § 14-22; Spyridakis (2018) no. 33. Also cf. Stathopoulos (2018) § 1 no. 86 on the principle of responsible lending and the further development of Art. 288 AK by way of harmonization of the law of obligations in the European Union.
[25] Tzakas (2018) 1004-1005.

[26] Tzakas (2018) 1005, with further references.

2 Civil Law Remedies in Case of Violations of the Transposing Law

Another issue addressed in legal doctrine is the lack of a comprehensive regulation of the civil law legal consequences in case of violation of the obligations imposed by the Transposing Law.

The MCD (and, accordingly, the Transposing Law) provide rather fragmentary provisions on this, such as the restriction of the right to cancel or alter the credit agreement to the consumer's detriment (Art. 18(4) MCD/Art. 17(4) Transposing Law) or to terminate it (Art. 20(3) MCD / Art. 19(3) Transposing Law) due to incomplete or improper creditworthiness assessment of the borrower, unless the lender can prove that the borrower wilfully withheld or falsified the relevant information. Apart from these isolated cases, the majority of the sanctions provided in the MCD are rather 'administrative' in nature, in the sense of imposing a number of obligations on the credit institutions with a view to encouraging responsible lending.

This approach is not new in the EU legislation regarding consumer credit and it does not constitute an unintended omission by the European legislator, but rather falls within the EU's prerogative to introduce the legal rules and harmonisation aimed for in each case while not 'encroaching' too much upon the national laws of the Member States. The EU legislator had applied a similar approach with respect to the Directive 2008/48/EC (CCD 2008)[27] (repealed in the meantime by Directive (EU) 2023/2225 (CCD 2023),[28] which follows the same pattern,[29] although it still remains to be seen how it will be transposed by the Member States) even though the both CCDs are in essence –contrary to the MCD–[30] maximum harmonisation directives.

Greek legal doctrine points out that, in the course of transposing the CCD 2008, the Greek legislator chose to go beyond the level of protection level afforded by the CCD 2008 itself and to provide in certain cases, to the benefit of the consumer, for stricter remedies than those included in the CCD 2008. However, this approach was not

[27] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ 2008 L 133, 22 May 2008, 66-92.

[28] Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC, OJ 2023 L 133, 30 October 2023, 1-67.

[29] See Recital 13 CCD 2023.

[30] See, e.g. Recital 9 MCD, which explicitly allows the Member States to maintain or introduce national rules beyond the MCD in respect of contract-law rules on the validity of credit agreements, contractual information and post-contractual issues not regulated in the MCD, as well as property-law provisions on land registration.

followed during the transposition of the MCD into Greek law. Although the choice of the EU legislator is deemed to be consistent with the minimum harmonisation concept underlying the MCD as a whole, the omission of the Greek legislator to provide for a comprehensive and robust system of legal consequences in civil law has been criticised in legal theory. As a result, the deciding judge has to resort to the general provisions of the AK on contract law and civil liability for damages and to incorporate them into the interpretation and practical implementation of the Transposing Law while upholding its spirit and purpose.[31]

2.1 Invalidity / Voidability of the Credit Agreement

The most drastic measure, from a general civil-law perspective, would be the possible invalidity or voidability (due to error or fraud) of the relevant credit agreement as a penalty for the credit institution infringing the Transposing Law. To do so, one has to resort to the relevant provisions of the general part of the AK. Legal doctrine has engaged with this possibility, inter alia in view of the practical difficulties that a claim for damages under the premise of the violation of the MCD would entail (for which see immediately below).[32] However, there are valid arguments, both in law and of a practical nature, against this approach:

The invalidity of the credit agreement appears to be too harsh a remedy, especially considering the lack of an express rule to this effect adopted by the legislator.[33]

Regarding the voidability, the application of the relevant provisions of the AK is equally difficult for a series of reasons:[34]To begin with, fraud on the part of the credit institution sets a substantially high burden of proof and will hardly be the case in most cases anyway – even more so considering that credit agreements in conjunction with the acquisition of residential property are wide-spread and very common in market practice.

In respect of avoidance of the credit agreement due to error, it must be considered that error needs to be substantial (Arts 140-2 AK) and it may not rely upon the internal will of the party in error (Art. 143 AK) in order to render a transaction voidable under Greek law. Additional hurdles for a borrower seeking to contest the validity of the credit agreement arise from Art. 144 AK, which prescribes that no error is at hand, if the contractual partner accepts the declaration of the party in error with

[31] Tzakas (2018) 1006-1007, who references examples of transposition in other Member States, in which new civil-law legal rules were introduced on the occasion of the MCD.

[32] Tzakas (2018)1008-1010.

[33] Tzakas (2018) 1009.

[34] Tzakas (2018) 1009-1011, with further references to case law and legal doctrine.

the same meaning as that which the latter had in mind (Art. 144 AK). In other words, borrowers seeking to invalidate the credit agreement need to establish that the violation of the Transposing Law was so fundamental to their decision to conclude a credit agreement that they would not have done so if the credit institution had duly fulfilled its statutory duties. It becomes obvious that the required standard of proof is rather high and it is difficult to discharge.

Finally, one has to consider the practical implications of rendering the relevant credit agreement null and void. These implications will usually be rather disadvantageous for the borrower since the loan will have to be returned immediately pursuant to the AK provisions on unjustified enrichment (Arts 904-13 AK). In addition, it is not entirely undisputed whether the invalidity of the credit agreement automatically leads to the invalidity also of the land charges, mortgages or other contractual and *in rem* arrangements securing it. At least for mortgages, the invalidity of the secured claim leads to the invalidity of the mortgage, as well (Art. 1258 AK). However, legal doctrine suggests that the relevant security rights may remain in place in spite of the invalidity of the underlying credit agreement in order to secure the resulting claim for return of the loan, at least if this is in line with the intent of the parties.[35] If this view is affirmed, the borrower will have to take additional measures to ensure that the mortgage is rendered null and void as well –or this may not even be possible as long as the credit is not repaid. Finally, the onerous effect of the invalidity of the credit agreement has also been recognised by the ECJ –in respect of consumer credit agreements in general– in the *Kásler* case.[36]

2.2 Complementary/Analogous Application of the Transposing Acts of CCD 2008

Leaving aside the drastic consequence of rendering the credit agreement null and void in case of violation of the MCD, Greek legal doctrine has suggested that the remedies provided with the transposition acts of the CCD 2008 in the Greek legal system should be drawn on, in order to address the legal consequences of the violation of the Transposing Law (beyond the criminal and administrative law remedies already provided in the MCD). Tzakas[37] bases this view inter alia on the case law of the ECJ, which in essence affirmed that the CCD 2008 elicited protective results directly in favour of the consumers.[38] This case law will probably not become overturned

[35] See, e.g. Georgiades (2010) § 85 no. 16; Kritikos (1985) Art. 1258 no. 6; Tzakas (2018) 1009, with further references.

[36] ECJ 30 April 2014, *Árpád Kásler, Hajnalka Káslerné Rábai v OTP Jelzálogbank Zrts*, C-26/13, EU:C:2014:282, paras. 83-84.

[37] Tzakas (2018) 1007; cf. Tzakas (2019) 59-60, who notes the difference in legislative technique between the CCD 2008 and the MCD, the former advancing maximum harmonization while the latter being a minimum harmonization piece of legislation.

following the promulgation of the CCD 2023, given that it relies upon principles that underlie both CCDs.

Considering the discussion on the CCD2008 and the expanded scope and objectives of the CCD 2023, it can be argued that the solutions provided in the context of both CCDs are not necessarily suitable in the context of the MCD, as well, since the MCD is a minimum-harmonisation directive, as opposed to the CCDs. On the other hand, the CCD 2023 explicitly applies to consumer credits for the renovation of a residential immovable property in an amount exceeding EUR 100.000 and not secured by mortgage or a comparable security on immovable property; this indicates a nexus between the MCD and the CCD 2023.[39] Moreover, the (intended) regulatory gap of the Transposing Law in respect of civil-law consequences creates the need to seek those in existing rules and remedies of Greek and European law, whereby one of the guiding principles could and should be the similarities between the CCD2008 (which is currently still the only CCD transposed into the Greek legal system) and the MCD. More specifically:

a) Taking as a premise the similarities in the legal construction of the duties of transparent information to consumers under both CCDs, on the one hand, and the MCD, on the other hand,[40] it is plausible to apply, by way of analogy, certain remedies provided in the transposing act of the CCD 2008 into the Greek legal system (JMD Z1-699)[41] also to instances falling within the scope of the MCD. Examples include Art. 21(4) and 21(5) JMD Z1-699, which essentially (i) force the lender to adjust the actual APRC applicable to a credit agreement on the basis of an – erroneously calculated – lower APRC that was stated in the agreement by mistake, and (ii) prohibit the imposition on a borrower of costs and fees or the unilateral adjustment by the lender of the interest rate or other fees which the lender failed to present and explain in sufficient detail and a transparent manner prior to contract conclusion.[42]

b) The violation of a series of duties imposed by the MCD and the Transposing Law on the lenders and the credit brokers, such as the clear and understandable

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[38] See ECJ 9 November 2016, *Home Credit Slovakia a.s. v Klára Bíróová*, C-42/15, EU:C:2016:842, para. 73; ECJ 27 March 2014, *LCL Le Crédit Lyonnais*, C-565/12, EU:C:2014:190 paras. 41, 43.

[39] See Recital 25 and Art. 2 (3) CCD 2023.

[40] In fact, both pre- and post-contractually, e.g. in case of changes to the applicable interest rate; cf. Art. 27 MCD and Art. 11 CCD 2008 / Art. 23 CCD 2023.

[41] Joint Ministerial Decree Z1-699/2010, Adaptation of Greek legislation to Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 (*Προσαρμογή της Ελληνικής νομοθεσίας προς την οδηγία 2008/48/ΕΚ του Ευρωπαϊκού Κοινοβουλίου και του Συμβουλίου της 23ης Απριλίου*), GGI B’ 917/23 June 2010.

[42] See Tzakas (2018) 1007-1008, with further references to ECJ case law.

presentation to the consumer of all relevant credit costs and fees, the additional fees for complementary services, the calculation of the APRC, the compensation of the lender in case of early repayment, etc. can lead to financial losses suffered by the borrower. In such a case, the remedy both for the recovery of the losses in question and in order to force the violating parties to cease and omit similar practices in the future could be sought in the law of damages, both contractual and tortious (Arts 298, 914 AK).

While supporting this approach, Tzakas[43] also notes that a major difficulty in asserting damages claims for violations of the Transposing Law lies in the quantification of the damage. In this regard, it is interesting to look at potential scenarios:
Taking as basis for calculation of the damages the so-called difference theory (i.e. the difference between what the claimant would have had, if the damaging instance had not occurred, and what they currently have),[44] a quantifiable damage is not readily discernible in most cases covered by the MCD where the borrower did receive the loan funds. At the end of the day, a borrower who received the funds under the credit agreement, even though his rights to due and complete information, etc. under the MCD may have been violated, is enabled to fulfil the purpose for which the credit was taken out, e.g. acquisition or repairs of immovable property. Along the same lines, the defendant credit institution can bring forward the objection of a benefit accrued to the claimant,[45] which in the aforementioned examples shall consist of the acquisition or improvements (and resulting increase in value) of the residential property that the credit agreement facilitated, even if the property thus acquired or improved is burdened with a mortgage or other land charge.

The quantification and causation of damages is admittedly easier in case of an erroneous calculation of the APRC by the lender which results in higher credit costs for the borrower. In addition, this can be covered by the solution proposed under a) above.

An interesting, but also debatable scenario is if a borrower alleges over-indebtedness due to faulty or missing information provided by the lender pre-contractually or in the course of the performance of the agreement: Such a claim raises the questions as to where to draw the dividing line between over-indebtedness and 'acceptable' indebtedness, how to quantify the damage and how to establish the causal nexus

[43] Tzakas (2018) 1008.

[44] For the difference theory under Greek law in general, see Georgiades (2015) § 10 no. 6, § 29 no. 26; Filios (2011) § 171; Stathopoulos (2018) § 8 nos. 47-51; Spyridakis (2018) no. 163.

[45] However, there is Greek case law to suggest that the invocation of such an objection by the defendant credit institution may not necessarily be successful, *inter alia* in case it contravenes the principle of good faith; cf. AP 1463/2023, which overruled a relevant objection in respect of inadequate investment services.

between such damage and the credit granted/the lender's mistakes or omissions.[46] This scenario bears certain similarities to loans in foreign currency, for which see below in more detail (and in which the Greek courts admittedly did not rule in favour of the borrowers at the end).

Regardless of the difficulties in sufficiently identifying, establishing and quantifying the damage, legal doctrine considers damages to be an appropriate remedy also in case of violation by the creditor of their duty (under the provisions on loans in foreign currency) to either contractually stipulate the possibility of converting the loan into local currency or to arrange for sufficient hedging against the currency risk.[47]

c) In terms of both systematic consistency and practical expediency, the most appropriate remedy for violation of the MCD/the Transposing law appears to be the analogous application of Art. 8(3) JMD Z1-699.[48] This article provides that, in case the credit institution fails to carry out a proper and sufficient creditworthiness assessment of the consumer (or to update this in the course of the implementation of the credit agreement), the consumer is relieved of the costs of the credit provided, including interest, and they only have to repay the credit amount in accordance with the contractual provisions in place with the credit institution.

There are arguments both in favour and against this construction:

On the one hand, it could be argued that this remedy is exceedingly onerous for credit institutions since it affects the core of their business model and it eliminates the main underlying economic rationale for dealing in consumer credit agreements. This potential effect would be counterproductive, since it would deprive consumers of available housing credit possibilities and impair the housing market overall.

On the other hand, the forfeiture of the relevant fees and interest proceeds would be due to the credit institution's failure to observe its statutory duties. Since those are

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[46] The protection of a borrower from over-indebtedness by way of MCD-related statutory measures and its correlation with the law of damages raise further interesting issues about the legislator's (potentially paternalistic?) role and prerogatives and give rise to *praeter legem* considerations on the role and justification of damages in such cases (cf. e.g. the wording of Art. 18 MCD with that of Art. 18 CCD 2023: the latter explicitly states that the creditworthiness assessment should prevent over-indebtedness, unlike the MCD). However, this discussion goes beyond the scope of the present report.

[47] Tsolakidis (2018) 12-13.

[48] Tzakas (2018) 1011, who also references similar provisions in German (§ 505d BGB) and French (Arts L. 314-25 – L- 341-28 of the *Code de la consommation*) laws transposing the MCD. See, in the context of consumer credit regulation, ECJ 9 November 2016, *Home Credit Slovakia a.s. v Klára Bíróová*, C-42/15, EU:C:2016:842, paras. 68-69, 71; see also Klavanidou (2019) 50-52; cf. Mentis (2012) no. 42, who goes a step further and supports the analogous application of Art. 8 JMD also to non-consumer credits, analysing this in the context of the so-called 'self-responsibility' principle.

imposed by law, the affected credit institutions anyway have to set up and maintain appropriate processes to uphold these duties and to evidence their observance of the law (i.e. the burden of proof of the non-observance of the MCD duties would lie with the claimant consumer/borrower). Another argument in support of the analogous application of this provision in the context of the MCD is, apart from the similar interest setup of the parties, the fact that it addresses the main cost categories incurred by a consumer as the result of the violation of the MCD without having to delve into the dogmatic and factual nuances of the general law of damages, especially the difficulty in their quantification in this context, but also the issue of sufficient causation.

The remedies in question can be brought either as individual lawsuits or as a class action, especially after a 2018 amendment to the Greek consumer protection law that explicitly included violations of the Transposing Law as grounds for consumer-law class actions.[49]

The position advanced in Greek legal doctrine that legislative measures implemented in the context of the CCD 2008 can be applied without further ado to the Transposing Law in order to cover its (intentional) legislative gaps can be indirectly tested in the light of the *UniCredit* ruling of the ECJ,[50] which essentially interpreted two identical rules of the CCD 2008 and the MCD in different ways. In any case, the differences underlying the respective subject matter of the CCDs and the MCD need to be considered carefully in each case. The *UniCredit* precedent reinforces the view that the Greek statutory rules implementing the CCD2008 must be thoroughly assessed in each individual instance of analogous application to the MCD to affirm their applicability to the latter, as well.

The options outlined in this section rely heavily upon the transposing act of the CCD2008. Consequently, it remains to be seen how the Greek legislator will choose to transpose the CCD 2023 into the Greek legal system and to what extent the provisions of JMD Z1-699 will be revised or replaced. Given that the CCD 2023 mostly focuses on questions of scope and content of the duties it provides, it can be expected that the arguments examined above will still hold after its transposition. In any case, a renewed assessment in the light of the new national provisions will be needed.

[49] See Art. 10(A) in conjunction with Appendix II Law 2251/1994, Consumer Protection (*Προστασία των καταναλωτών*), GGI A' 191/ 16 November 1994, as amended.

[50] ECJ 9 February 2023, *UniCredit Bank Austria AG v Verein für Konsumenteninformation*, C-555/21, EU:C:2023:78, paras. 36, 39.

2.3 The Non-Observance of Reasonable Forbearance in Particular

In view of the amendment of the MCD –and the Transposing Law– with Art. 28 of Directive (EU) 2021/2167 and the clarification and elaboration of the element of reasonable forbearance as a duty of the creditor, a brief examination of potential civil-law implications arising for the creditor due to the non-observance of this requirement is warranted.

In the writer's view, none of the options and remedies presented above seem to be a suitable civil-law remedy for violation of the amended Art. 27(1) Transposing Law:

a) The invalidity/avoidance of the credit agreement altogether must be rejected for the same reasons as those stated above. In particular, such a remedy appears to be excessively onerous and disproportionate to the purpose of the provision at such an advanced stage of the relationship between lender and borrower; at the end of the day, the legislator does not aim at eliminating the credit relationship through the reasonable forbearance obligation, but rather it seeks to render it viable under circumstances that put its continuity and proper performance at risk. In addition, such drastic remedies would be practically inexpedient for the same reasons as those stated above.[51]

b) The law of damages would lead to the same gridlocks as mentioned above (0, notably the difficulty in quantifying the damage. Enforcement proceedings presuppose that the borrower breached their obligations under the credit agreement, most often the obligation to repay it. A claim for damages may not, of course, be based upon what the claimant would have had if the consequences of breach of contract had not been borne; this constitutes a logical leap for obvious reasons and contravenes the general principle that a claimant in damages may not invoke their own breach (*nemo turpitudinem suam allegans auditur*). Even assuming that a claim for damages could at least be *prima facie* entertained, the element of causality would be at least questionable: the 'damage' suffered by the claimant in case of enforcement ultimately relies upon and is caused by the contractual breach, and not the lack of forbearance by the creditor.

c) Finally, the analogous application of Art. 8(3) JMD Z1-699 also does not seem to be particularly helpful in this regard. The costs regulated in this provision are not relevant in the context of enforcement proceedings and an analogous application of Art. 8(3) JMD Z1-699 must also be excluded due to lack of equivalence in the regulatory content of each provision. Moreover, even Art. 8(3) JMD Z1-699 provides

[51] *Contra*, Mentis (2012) no. 44: Although he does not refer specifically to the MCD requirement of reasonable forbearance, he affirms, in regard of 'over-indebting agreements', among other options, the invalidity of the agreement according to the general provisions of the AK.

that the credit has to be repaid, while enforcement is imposed exactly due to arrears in its repayment.

In view of the above, failure by a credit institution to show reasonable forbearance prior to the initiation of enforcement proceedings could probably be used at best as a procedural-law defence against such proceedings, i.e. as an objection (*ανακοπή*) in connection with the underlying claim, in accordance with the provisions of Arts 933 ff. of the Greek Code of Civil Procedure (*Κώδικας Πολιτικής Δικονομίας*; KPolD).[52] Reasons pertaining to the underlying claim are not further defined in the KPolD and this assessment is left to the deciding court.

It is also open to interpretation –and not really apt for generalisation– what exactly the legal consequence would be that the Greek courts affirm and adjudicate (if at all) in case of violation of the reasonable forbearance requirement. The effect would probably consist either in the postponement or the complete invalidation of the enforcement proceedings, but this would essentially depend on the facts of each case and further variable factors which may not always be assessed or foreseen ex ante, such as the borrower's possibility to settle the debt while the reasonable forbearance lasts or as the result of the specific forbearance measures chosen and implemented in each case.

In this regard, it should be considered that the avoidance of enforcement proceedings may give rise to a claim for damages of the person on whom enforcement measures were actually levied invalidly, pursuant to the explicit provision of Art. 940 KPolD, but also based on equity considerations arising out of the general clause of good faith in the AK (Art. 281) and the European Convention on Human Rights.[53] Therefore, assuming that Greek courts affirm the definitive avoidance (not simply the postponement) of enforcement proceedings due to lack of reasonable forbearance, the violation of the provision of Art. 27(1) Transposing Law by a creditor could, further down the process, be sanctioned with a claim for damages. Obviously, this cannot be regarded as a direct legal consequence of Art. 27(1) Transposing Law, but should be mentioned for the sake of completeness.

Therefore, it remains to be seen if and how Art. 27(1) Transposing Law will be applied by Greek courts in the context of enforcement proceedings. As of now and on a first level of evaluation, it appears plausible to search for the legal consequences of this new requirement rather in procedural than material law.

[52] For the procedural-law remedy of objection to the enforcement proceedings and the grounds giving rise to it, including those pertaining to the underlying claim, see Margaritis (2018) Art. 933 nos. 56-70; Mazis (2021) Art. 933 nos. 10-16; Nikas (2023) § 26; Gesiou-Faltsi (2022) § 39.

[53] For more details, see, e.g. AP (plenary session) 12/2009, AP 90/2023 (both published in Isocrates).

IV The Judicial Treatment of the Transposing Law in Greece

1 General Assessment of the Impact of the MCD

Upon promulgation of the Transposing Law, it was expected that this would elicit a number of lawsuits between credit institutions and borrowers and, as a result thereof, numerous opportunities to obtain a judicial clarification of its open points and controversial or unregulated aspects.[54] However, this expectation has not really materialised in the almost eight years since the entry into force of the Transposing Law. On the contrary, at least on the basis of court rulings published in Greek legal databases, only a handful make specific mention of it.

Non-performing loans, including housing credits backed by mortgages, continue being an unresolved issue in Greece and the relevant discussion and market practice occasionally generates social, economic and political tension.[55] In view of the persistence of the relevant issues in public and legal discourse, the lack of judicial engagement with the Transposing Law raises certain questions, including what the possible causes for this are.

A possible explanation may lie in the fact that the NPL market in Greece, after its initial boom during the sovereign debt crisis and its aftermath, has now more or less 'crystallised' and the resulting court disputes are fewer or underreported in the official legal databases.

Another factor may be that, according to market information, the NPL (including housing loans) are being handled to a substantial extent outside of court. The Greek Ministry of Finance introduced new measures in late 2023 for the out-of-court settlement of mortgage-backed credit debts, aimed at reducing mortgage enforcement.[56] The settlement/refinancing of NPL outside of court may have been further enabled by the low prices (in most cases at a fraction of the nominal value of the outstanding loan balance) at which the majority of such loans were acquired by the NPL management companies and funds that sprang up in the Greek market over the last ten years. The low acquisition cost provides more leeway to NPL managers for alternative payment arrangements while maintaining sustainable profit margins

[54] Tzakas (2019) 96.

[55] For a brief stocktaking of the status quo of 'red loans' at the time of the promulgation of the Transposing Law, see Moraitis (2017) 239-241.

[56] E. Tzortzi, 'New improvements to the out-of-court procedure (Νέες βελτιώσεις στον εξωδικαστικό)', Kathimerini, 6 December 2023. Available at: https://www.kathimerini.gr/economy/562766902/nees-veltioseis-ston-exodikastiko/

and, accordingly, it potentially contributes to the reduction of NPL-related court disputes.

However, at the same time a large number of mortgage enforcements over immovable property have and continue to take place in Greece. In addition, such proceedings are further boosted by the possibility of electronic auctions.[57] It is estimated that more than 63,000 electronic auctions on immovable property were carried out between 1 January 2018 and 30 September 2023, with ca. 81% of those having been enforced by banks or credit claims management entities and 76,2% of them having been levied against natural persons.[58] It was further reported that, as of February 2024, more than 10,000 houses were 'blocked' in the e-auction process due to bureaucratic complications and pending court measures against the enforcement proceedings.[59]

Finally, given the typically lengthy proceedings before Greek courts, it is possible that the cases brought before the Greek courts till now predominantly predate the entry into force of the Transposing Law. Accordingly, a surge in court cases governed by the Transposing Law may be still looming ahead.

The present review does not purport to delve in detail into the issues of non-performing housing loans, but only serves as backdrop for the implementation and practical implications of the MCD and the Transposing Law in Greece. In addition, it should be noted that the EU legislator turned their attention specifically to the market of housing non-performing loans and expressed its policy decision that, when such a loan is purchased by or otherwise acquired by a credit servicer loan manager, this should not be disadvantageous for the borrower.[60]

For our purposes, it is noteworthy that the concretisation of the duties of credit institutions under the MCD (in fact even more so after the amendments to the MCD by the Directive (EU) 2021/2167) does not seem to create an impetus for consumers

[57] For the legal framework on e-auctions currently in force, see law 4738/2020, Debt settlement and second chance and other provisions (*Ρύθμιση οφειλών και παροχή δεύτερης ευκαιρίας και άλλες διατάξεις*), GGI A' 207/27 October 2020, as amended, which transposes the Directives (EU) 1023/2019 and (EU) 2017/1132 on restructuring and insolvency measures.

[58] For various statistical data analyses on e-auctions, see Kiki & Trompoukis, *Auctions in Greece (Οι πλειστηριασμοί στην Ελλάδα)*. Available at https://auctions.lab.imedd.org/, updated as of 21 December 2023.

[59] E. Tzortzi, 'More than 10,000 properties for sale stuck (Εγκλωβισμένα περισσότερα από 10.000 ακίνητα προς πώληση)', Kathimerini (daily newspaper), 26 February 2024. Available at: https://www.kathimerini.gr/economy/562900822/egklovismena-perissotera-apo-10-000-akinita-pros-polisi/

[60] See Directive 2021/2167/EU, recital (52) and Art. 28 of the same, introducing the amendments to the MCD described under 2. above.

to resort to the courts in order to challenge bank practices and ensure or seek the consistent observance of the Transposing Law. The data at hand does not suffice to examine and ascertain whether this is due to a lack of the relevant incentives (including the financial means for protracted court disputes) on the side of the borrowers or to compliance of the Greek banks with the various requirements imposed by the MCD.

2 Selective Case Law Review: The (Ongoing) Discourse on Mortgage-Backed Loans in Swiss Francs

The discussion on the *ratione temporis* scope of the Transposing Law above (section IV 1) is reflected –at least indirectly– in the subject matter of the sparse Greek case law on the Transposing Law and/or the MCD. The few officially published court decisions since its entry into force that refer to the Transposing Law essentially concern the issue of the mortgage-backed loans issued in Swiss francs, which predominantly predate its entry into force. In addition, rather than serving as the law directly applicable to each dispute brought before the court, the Transposing Law is most usually treated as a guiding principle.[61] Legal doctrine noted this approach with approval[62] and even urged the Greek legislator to intervene and accord to Swiss-franc borrowers the advanced protection offered by the new legislation, even if they are not covered by its temporal scope.[63]

More specifically, the earliest case law following the entry into force of the Transposing Law did not apply it directly, since the disputes in question predated it. However, it still resorted to its provisions and the underlying rationale of the MCD altogether in connection with the question whether housing loan agreements concluded in Swiss francs are valid under Greek law and if they should be interpreted and applied as if they had been concluded in euro from the outset or not. The brief overview below focuses specifically on the judicial invocation of the MCD and the Transposing Law since 2018.

The multi-member Court of First Instance of Patras acknowledged in 2018[64] that the MCD does not apply to credit agreements concluded before its entry into force on 21 March 2016,[65] but it should be regarded as having a particular guiding role also in

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[61] See CA Thrace 24/2017, EllDni 2017, 487-493 which referenced the provisions of the MCD on loans in foreign currency as a guiding principle before the transposition of the MCD into Greek law.

[62] Mpolos, (2017) 497-498, who seems to suggest that the court did not go far enough in this "anticipatory" application of the impending Transposing Law.

[63] Pelleni-Papageorgiou (2015) 340.

[64] MCFI Patras 524/2018, published in Isocrates.

respect of agreements falling outside of its scope, including its article 23 on foreign currency loans. The deciding judge, following a lengthy analysis of the European and Greek law on the matter, determined that the mortgage-backed housing credit agreement concluded between the claimant borrower and the defendant bank in 2007, by which the original loan agreement in euro of 2006 was concluded anew in Swiss francs, was invalid due to the lack of transparency and the resulting abusiveness of the general terms and conditions (GTC) of the lending bank. Accordingly, the borrower's obligation to repay the loan was defined by reference to the original loan agreement of 2006 in euro, without any reference to the EUR/CHF exchange rate. Even if the court did not go as far as explicitly spelling this out in categorical terms, it still sought to derive an argument from the *ratio* of Art. 23 MCD in favour of a borrower under a Swiss-franc loan agreement, while at the same time affirming that the MCD and the Transposing Law did not apply to the dispute at hand.

Along similar lines, the Court of Appeals of Thessaloniki referred in a 2018 ruling[66] to Art. 22 Transposing Law (Art. 23 MCD), although it was once again not directly applicable to the dispute at hand, as a provision that justifies the application of Art. 388 AK (unexpected change of circumstances).[67] The ruling explicitly qualifies the Transposing Law as a guiding principle for the legal assessment of the dispute in question, in spite of its non-applicability *ratione temporis*: more specifically, the extreme fluctuation of the EUR/CHF exchange rate since conclusion of the loan agreement in question constituted a severe change of circumstances that fulfils the criteria of Art. 388 AK and allows the borrower to seek the judicial adjustment of the loan agreement provisions. In this case, the corrective action of the court consisted in the adjustment of the monthly loan repayment rate according to the fluctuation of the EUR/CHF exchange rate by eliminating or reducing, depending on specific fluctuation thresholds over the life of the loan, the bank's profit margin.[68]

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[65] The Court did not further assess the discrepancy between the entry into force of the MCD and that of the Transposing Law.

[66] CA Thessaloniki 1663/2018, published in Isocrates.

[67] Art. 388 AK essentially prescribes the right to seek the judicial adjustment of contractual arrangements in the event of extraordinary and unforeseeable drastic changes of the circumstances on which, considering good faith and commercial morals, the parties based the conclusion of the agreement and provided that such changes render the debtor's contractual position excessively onerous. For more details on this provision of the AK and its legislative configuration and practical application under Greek law, see, among others, Stathopoulos (2018) § 22, with extensive references to case law and legal doctrine.

[68] Based on this court ruling, Mentis (2018) 965-968, 973-974, suggested that loan agreements in foreign currency concluded in Greece are null and void (at the very least, the obligation to repay them in Swiss francs) due to lack of transparency (by reference to the Greek statutory rules on consumer protection) and specifically referred to the relevant provisions of the Transposing Law to further reinforce this argument.

The Court of Appeals of Athens, ruling in 2018 on a class action by various consumer unions against a Greek bank,[69] referred *inter alia* to the Transposing Law as an argument in favour of the validity under Greek law of loan agreements concluded in Swiss francs. It then went on to essentially uphold the validity of the disputed loan agreements and the borrowers' obligation to repay the loans on the basis of the EUR/CHF exchange rate on the date of each loan repayment. In addition, the court explicitly rejected the applicability of Art. 388 AK, thus directly contradicting the Court of Appeals of Thessaloniki (see above).

The diverging views of the Greek lower courts on the matter eventually led to the matter being decided by the Greek Supreme Court (*Άρειος Πάγος,* AP), following a petition for cassation filed by the consumer unions that were defeated before the Court of Appeals of Athens. In a ruling from 2021,[70] the AP essentially confirmed the line of argumentation brought forward by the Court of Appeals of Athens in its ruling 911/2018. Once again, due to the temporal scope of application of the Transposing Law, the AP made only limited reference to it in passing as a justification basis for the valid conclusion of loan agreements in foreign currency in Greece.

Ever since the Greek lower courts have consistently upheld the validity of loan agreements concluded in Swiss francs and the borrowers' obligation to repay those based on the EUR/CHF exchange rate of the respective payment date.[71]

It was mentioned from the outset that the case law cited above addresses the Transposing Law only indirectly and consistently points out that it may not apply retrospectively. Therefore, it still remains to be seen if the Greek courts would opt for a different approach, should they be called to rule on disputes that can be subsumed directly to the Transposing Law. Art. 22 Transposing Law obliges the lending credit institution to (i) either contractually stipulate the borrower's right to convert a loan granted in foreign to local currency in case of exchange rate fluctuations over 20% or (ii) to ensure that the loan is secured throughout its duration by way of financial instruments for hedging the foreign currency exchange risk. Accordingly, it may be reasonably argued that the Swiss franc loan cases hitherto decided by Greek courts might have had a different outcome if evaluated in the light of the aforementioned provision; in particular, the courts would probably be more amenable to affirming the possibility to convert a loan granted in foreign currency into euros.[72] In any case, it

[69] CA Athens 911/2018, published in Isocrates.

[70] AP 948/2021, published in Isocrates.

[71] See, e.g. CA Piraeus 17/2024; CA Athens 524 /2024, both published in Isocrates.

[72] See Tzakas (2019) 94-96.

should not be expected that cases to which Art. 22 Transposing Law applies directly are brought before Greek courts soon; following the experience of the Swiss franc loan agreements, the Greek housing market has become overly cautious with loan agreements concluded in a currency other than the Euro.

V Closing Remarks

The Transposing Law undoubtedly created a clear and detailed legal framework for the mortgage-backed housing credit market in Greece, which continues being developed and elaborated on as the result of further legislative initiatives on the EU level for the same subject matter. Compared with the CCD 2008, the MCD has set out a higher standard of protection for residential borrowers, especially in terms of the pre-contractual information obligations and the principle of responsible lending enshrined in it; this can be attributed in part to the hard experiences of the repeated financial crises since 2008.[73] In fact, this conclusion is further reinforced by the fact that the CCD 2023 draws on the MCD in respect of certain amendments to the CCD 2008, such as the alignment on data categories to be considered for creditworthiness assessments or the responsible lending requirements imposed on credit providers.[74] This constitutes a further indication of the impact and importance of the MCD in the field of consumer credit overall.

At the same time, as pointed out in the preceding paragraphs, a profound and tangible impact of the Transposing Law is not readily discernible in Greek legal and market practice over the course of the past eight years since its promulgation. This 'silence' cannot be summarily attributed to a lack of effect of the Transposing Law in Greece. Several potential reasons can account for it, including the relative 'normalisation' of the Greek market overall, the number of out-of-court settlements (according to unofficial market sources as opposed to legal databases) in related disputes and the *ratione temporis* scope of the Transposing Law.

The public and scientific discussion on the Transposing Law in Greece focuses mainly on the specific implications and legal consequences of its non-observance by the creditors. As a matter of general principle, the conscious choice of the EU legislator to leave the specific civil-law remedies to the national legislators' discretion is not necessarily amiss; the options expounded on above show that the Greek legal system

[73] See Pelleni-Papageorgiou, (2015) 340. Cf. specifically for the protection of borrowers in foreign currency, Tsolakidis, (2018) 14-15, who notes that the protection accorded to the borrowers should balance both the interplay of interests between borrowers and banks and the need to uphold the principle of freedom of contract and avoid extraneous (i.e. legislative) interventions in the fundamental civil-law principle of private autonomy.

[74] European Commission, Impact Assessment Report Accompanying the Proposal for a Directive of the European parliament and of the Council on Consumer Credits, 30 June 2021 {COM(2021) 347 final}, 66. Available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021SC0170

already has at its disposal a number of remedies that can be resorted to in order to fulfil the regulatory objective of the MCD and the Transposing Law. At the same time, a comparative examination of the remedies available across the EU Member States is warranted, in order to ensure that the same –or at least comparable– level of protection is afforded to residential borrowers across the board and that any unintended gaps and discrepancies are sufficiently addressed, potentially through a further amendment of the MCD in the direction of maximum harmonisation. In this regard, the conclusions of the Impact Assessment of the European Commission are eagerly anticipated.

In the same spirit, it is worth noting certain voices in Greek legal doctrine which have sought to extend the applicability –or at least the practical and dogmatic implications of the MCD and the Transposing Law– to non-consumer loan agreements.[75] This constitutes a further token of the perceived value and usefulness of the MCD and the far-reaching implications that it could have in the bank credit market and practice as a whole.

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[75] Tzakas (2017) 243-244, refers to Art. 28 MCD (Art. 27 Transposing Law), which allows the parties to agree that the transfer of the mortgaged property or the proceeds from its sale to the creditor suffice in order to fully repay the credit. This amounts to a tacit abolition of the prohibition of the *lex commissoria* under Greek law and Tzakas suggests that this abolition should not be restricted to consumers. It is at the very least debatable, if this was a conscious choice of the Greek legislator to overrule the prohibition of the *lex commissoria* in the AK as a whole.

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CHAPTER 5

THE IMPACT OF THE MCD ON HOUSING CREDIT IN HUNGARY IN THE CONTEXT OF POST-2015 HOUSING POLICY INTERVENTIONS

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I Introduction

Housing loans in Hungary started after the year 2000, with the legal framework having been established in the late 1990s. Between 2000 and 2002, under the Hungarian Civic Alliance Party government, housing loans were heavily subsidised by the state, leading to a rapid increase in housing loans. A significant part of the subsidies (interest subsidies and the personal income tax credit) was a burden on future budget expenditure, and by 2004 this burden was a serious problem for the new Socialist (Alliance of Free Democrats) government. In 2004, the government reduced subsidies for HUF loans, which led banks to offer risky but cheaper foreign currency denominated (FX) loans. The FX loans were much more affordable even for lower-middle income families. The share of the foreign currency denominated loans increased to 76% of all housing loans by 2009, including untied, mortgaged consumer loans. [1] Mortgage-backed consumer loans were preferred by both the banks and the borrowers, because of their simpler underwriting process. Untied loans could be used for any purpose, although most of them were in fact used for housing. If housing

[1] Hegedüs & Somogyi (2016) 210.

mortgage loans alone are taken into account, the share of FX loans was 64%. A higher level of contractual freedom and very poor regulatory frameworks in the credit market were typical; the consumer has been even less powerful than in other EU Member States against the unfair practices of non-banking lenders or credit intermediaries. The demand generated by household lending was a major contributor to economic growth, and economic policy makers were concerned about the problem of cutting back on housing subsidies. The solution was the liberal treatment of housing loan contracts and the authorisation of cheaper foreign currency lending, which in a few years became the dominant element in household lending. The regulators (the Banking Supervisory Authority and the Hungarian National Bank) were aware of the risks but did not feel the need to interfere in the contracts between citizens and banks. For this reason, Hungary was severely affected by the 2008 crisis.

There were large differences between the new Member States in this respect. For instance, the Czech-Hungarian comparison shows that in Hungary foreign currency lending alone was a strong determinant of the severity of the crisis,[2] while the Czech Republic, which did not use FX loans at all, experienced a shorter and milder downturn. In Poland, even relatively light regulation of foreign currency lending – namely that banks were obliged to keep the debt-service-to-income ratio below a certain level also in the case of FX loans– mitigated the crisis, in contrast to the Hungarian case, where the risks of foreign currency lending were left to the agreement of the bank and the borrower.[3] In countries such as Bulgaria and Romania, where credit was slow to take off, the damage from the crisis was inherently less severe. [4] On the contrary, the Baltic countries, where lending grew rapidly and FX loans were the dominant product, were hit the hardest. [5]

Based on the experience of the 2008 crisis, there are essentially three problems to be solved:

a) Housing loans, which play a very important role in the housing system, should be adapted to household solvency and risks should be transparent and manageable. At the same time, regulation must be careful not to unduly exclude social groups who would be able to pay their loans. The MCD aims to establish prudent lending practices, eliminate moral hazard and build an efficient market system.

b) An important part of an efficient market system is that, even with prudent lending and information sharing, there may be specific cases where a borrower is unable to make repayments (illness, unemployment, family reasons, etc.), for which there need to be effective solutions with a social element.

[2] Hegedüs *et al.* (2011) 327-331.
[3] Augustyniak *et al.* (2022) 11-12.
[4] Bauer *et al.* (2013) 31-33.
[5] Bauer *et al.* (2013) 31-33.

c) However, a consequence of the MCD is that low-income households are unable to access owner-occupied housing because they are not creditworthy (apart from in the case of intergenerational transfers). The role of social and affordable housing programmes is precisely to provide housing, either subsidised rental housing or a limited ownership solution (like limited equity, land trust or shared ownership models), to families who are not creditworthy.

Consistent adherence to these principles points in the direction of an efficient housing system, but these principles may conflict with economic, family or environmental policy objectives. In the period 2009-2015, the government applied a number of *ad hoc* solutions to the above challenges, which were analysed in a number of studies, often as individual solutions (with questionable social impacts) that could not be implemented in a systematic way.[6] The aim of this paper is to summarise the steps taken to introduce the MCD in Hungary to stabilize the housing finance based on the literature.[7] We try to highlight the points where this regulation conflicts with other policy interests of post-2015 housing interventions, and to show the possible consequences of the latter. The paper focuses on the mortgage debt rules for households and reviews the effects of the regulations in the above-mentioned three areas.

II Implementation of the MCD in Hungary, Mortgage 'Debt Brake' Rules and their Evolution

Due to the severe impact of the 2008 crisis in Hungary, the Government has initiated a series of legislative reforms in order to reinforce the protection of consumers and the stability of the financial market in relation to mortgage loans. The MCD has been implemented in the complex legal framework governing mortgage loan agreements in Hungary in this context.[8]

Within the general legal framework defined by the Hungarian Civil Code,[9] the Act on Judicial Enforcement[10] and the Act on Credit Institutions and Financial Enterprises,[11] the specific rules concerning mortgage credit agreements and pre-contractual commercial communication are contained in the Act on Credit Agreements for Consumers.[12]

At the same time, the rules of the MCD are often elaborated upon by means of secondary legislation, for example as regards the calculation of the annual percentage

[6] Csizmady *et al.* (2019); Csizmady *et al.* (2017); Augustyniak *et al.* (2022).
[7] Fáykiss *et al.* (2018); Kim (2021); Simon (2017).
[8] The summary of the implementation of the MCD in Hungary was based on Fejős (2017).
[9] Act V of 2013 on the Civil Code.
[10] Act LIII of 1994 on Judicial Enforcement.
[11] Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises.
[12] Act CLXII of 2009 on Credit Agreements for Consumers (CCA).

rate of charge,[13] the specifics of creditworthiness assessment,[14] or the knowledge and competence requirements of mortgage credit intermediaries.[15]

The Hungarian National Bank (HNB) Decree 32/2014 (IX. 10.) was one of the first in Europe to introduce debt brake rules, applying the legally binding borrower-focused rules from 1 January 2015.[16] These regulations mandated the use of two ratios (1) Loan-to-Value ratio (LTV) and (2) Debt-Service-to-Income ratio (DSTI). LTV determines the maximum amount of credit that can be borrowed in proportion to the market value of a collateral at the time of the loan assessment, while DSTI determines the maximum amount of repayments that borrowers can make in proportion to their regular net verified monthly income.

The objective was in line with the MCD's expectations to curb excessively risky lending by reducing the expected loss in the event of default; both the risk of default by borrowers and the credit risk for lenders are reduced. The limits used in the two formulas are set differently by the legislation for the specific terms of the creditor and the credit product. These provisions allowed the regulation to minimise unintended side effects. As credit is a relevant factor for economic growth, it was important that the regulation should not unduly discourage lending. The conditions and parameters of the debt brake from 2014 till 2024 have been amended eight times by the legislator, which has led to a tightening of the lending limits.

1 Loan-to-Value Ratio

In Hungary, the LTV limit is generally set at 80%, but this can vary based on the type of loan (including if it is a FX loan) or the borrower's characteristics. The LTV limit prevents borrowers taking on too much debt relative to the value of the property, which could become problematic if property values decline or if the borrower defaults.[17]

With the sharp rise in house prices after 2015, the tight lending rules were a significant barrier to borrowing, especially for first-time home buyers in terms of the 20% down payment requirement. Based on an impact study that showed that the

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[13] Government Decree 83/2010 on the Determination, Calculation and Publication of the APRC.

[14] Government Decree 361/2009 on Responsible Lending and Assessing Creditworthiness.

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[16] Based on Borrower-based measures (LTV, DSTI) Available at: https://www.mnb.hu/en/financial-stability/macroprudential-policy/the-macroprudential-toolkit/borrower-based-measures-ltv-dsti

[17] Kim (2021) 116-117.

earnings of young professionals were likely to increase significantly over the life of the loan, making this group a lower lending risk, the HNB has relaxed the LTV rules for young first-time buyers. A 2024 amendment to 32/2014 (IX.10) HNB order applies a preferential LTV limit of 90%, 10 percentage points higher than the general limit, for individuals under the age of 41 who do not currently[18], and have never, owned at least 50% of any residential property.

Several regulations that had been a barrier to borrowing for administrative reasons have also been relaxed.

Table 1 LTV rules in 2024

Loan currency	First-time buyers	Other borrowers
HUF	90%	80%
EUR	50%	50%
Other FX	35%	35%

2 Debt-Service-to-Income Ratio

According to the HNB regulation, the value of the DSTI ratio depended on the household's income (a higher DSTI ratio may be safe for higher incomes) and the loan product (what currency it is denominated in, whether it is fixed or variable rate, and if fixed, for how many years the interest rate is fixed). Lower rates are applied for the FX loans. Loans with a shorter fixed interest period, which are more exposed to interest rate risk, are subject to lower DSTI limits. The income categories were changed several times (from HUF 350,000 to HUF 600,000) because of the inflation and wage increase between 2014 and 2024. Overall, DSTI regulations can be said to encourage borrowers to opt for fixed-rate loans, which offer more stability but may come with slightly higher interest rates.

Table 2 DSTI rules for HUF mortgage loans with maturity more than 5 years

Monthly Net Income	Fixed interest rate period		
	Less than 5 years	5-10 years	More than 10 years
Less than 600 000 HUF	25%	35%	50%
More than 600 000 HUF	30%	40%	60%

3 Debt-to-Income Ratio

An HNB regulation of 1 January 2023 has created the legal possibility to introduce the Debt-to-Income (DTI) as another parameter for measuring the ability to pay when granting credit. This is an indicator that determines the maximum amount of loans that debtors are allowed to take out as a proportion of their annual income. DTI is

[18] Grosz *et al.* (2023) 25-53.

used in several European countries as it is considered to be a more objective measure of solvency because it is not distorted by the effect of the interest rate level at the time the loan is granted.[19] The timing and calibration of its application in Hungary will be decided by the HNB's Financial Stability Board in consultation with market participants, depending on the evolution of risks.

III Mortgage Trends and Non-Performing Loans in 2014-2024

In the past ten years, the debt brake rule has contributed to the security of the monetary system.[20] The share of non-performing loans has been declining since the mortgage rescue programme between 2008 and 2014,[21] apart from the temporary spike caused by the Covid-19 related crisis. At the same time, an important development is that the actual size of the total stock of housing loans has increased from HUF 7,375 billion only to HUF 11,579 billion over the period (the high level of older loan repayments played a significant role in the slow growth of the total stock), while the ratio of total outstanding housing loans to GDP has fallen from 22% to 15%. On this basis, the loan braking provisions of the MCD programme may have been successful, but it appears that without subsidies and subsidised loans, lending would have fallen. Given that housing credit is an important factor in the economic growth model of Hungary (against the case of Germany where economic growth is mainly driven by the level of export)[22] this has been a constant concern for economic policy makers. Programmes were therefore launched that, essentially in line with the rules on debt brake, led to an increase in credit. In particular, the ratio of subsidised loans to non-subsidized loans reached 75% in 2020 and then fluctuated between 79% and 125% at its highest level. A decisive factor, one might say, especially in years when interest rates are rising, which, despite the MCD rules for variable rate loan products, increase the risk of default. For this reason, it is very important that society puts in place solutions that address these cases and avoid ruining a life's journey due to lack of housing.

[19] Kim (2021) 147.

[20] See Table 3.

[21] Csizmady *et al* (2022).

[22] Kohl & Spielau (2023) 446.

Table 3 Main housing loan trends between 2014 and 2023

	Housing loan interest rate (%)	Total outstanding housing loan bn Ft	Housing loan to GDP ratio	New market housing loans (bn HUF)	New subsidized housing loans (bn HUF)	Ratio of subsidized loans to market loans	Non-performing loan ratio (RHS)	The average loan to value ratio [23]	
								Budapest	Countryside
2014	6,10	7 375	22%	242	0	0%	19,7%		
2015	5,26	6 427	18%	329	0	0%	22,2%		
2016	4,70	6 301	17%	389	77	20%	19,8%		
2017	4,01	6 292	16%	549	94	17%	12,3%		
2018	4,97	6 649	15%	781	61	8%	8,1%		
2019	4,12	7 740	16%	785	591	75%	5,3%	49%	53 %
2020	3,97	9 018	18%	777	763	98%	3,5%	54%	56 %
2021	4,41	10 558	19%	1033	813	79%	3,3%	49%	49 %
2022	10,89	11 212	17%	733	914	125%	4,3%	42%	44%
2023	8,65	11 579	15%	466	397	85%	3,4%	40%	44%

Sources: HNB, CSO [24]

The safety of the monetary system is ensured by the programmes offered to borrowers with non-performing loans. In Hungary, three such major programmes have been set up (apart from other initiatives by NGOs that provide *ad hoc* assistance to people facing foreclosure in individual cases).

The National Asset Management Agency, created in 2012, has bought out the mortgages of around 50,000 debtors from the banks and allowed the former owners

[23] HNB, Housing Market Report, 2024 MAY, Figure A12 https://www.mnb.hu/en/publications/reports/financial-stability-report/financial-stability-report-may-2024

[24] HNB, Report on Financial Stability 2024 –MAY. Figure 32 and 41. https://www.mnb.hu/en/publications/reports/financial-stability-report

to continue living in the flats they bought or built as tenants (at 10-30% of market rents). This was a special scheme to rescue borrowers who had defaulted as a result of the 2008 financial crisis. In 2020, the scheme was stopped, and tenants were allowed to buy back their flats on preferential terms, but there were still four thousand housing units whose tenants did not want to buy them back or could not buy them back, which were taken over by a non-profit housing fund managed by MR Public Housing Fund Non-profit Ltd.

The other main option that has been created by the government is the institution of private bankruptcy (Act CV of 2015 on the settlement of debts of natural persons). However, the programme proved to be less efficient in terms of providing a real solution to insolvent families and has so far reached only 2,000 families, despite initial high expectations (20,000 families). The main reasons for this low take-up are the restrictive rules, the complicated procedures and the unfamiliarity of the model.

Finally, the third programme is debt management, which the central government has very tightly restricted. Local governments can provide financial support for low income households who are in arrears with their housing maintenance costs. However, the amount of the subsidy and the number of supported households are insufficient compared to the needs, mainly because the central government does not contribute to the financing of the scheme.

1 Main Housing Policy Interventions and Mortgage 'Debt Brake' Regulations

1.1 Family Home Support

The CSOK housing support scheme,[25] which was introduced in 2015 and ceased at the end of 2023, provided non-reimbursable support to families with children, and in addition offered a subsidised loan structure. A very strong motivating factor behind the scheme was to increase the number of children born, improve the fertility rate (which was 1.88 in 1991 and decreased to 1.44 by 2014)[26] and encourage housing construction and investment.

These two aspects dominated the internal structure of the scheme. Thus, if a family had more children, it received progressively more subsidies, and if it built a new dwelling, it received 4-5 times more than a family buying an existing dwelling.
The conditions of the subsidy changed over the years, removing income limits and restrictions on the size of the dwelling. The social targeting of the subsidy changed as well, as house prices rose rapidly, so that the subsidy increasingly favoured higher

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[25] 17/2016 (II. 10) Korm. Rendelet a használt lakás vásárlásához, bővítéséhez igényelhető családi otthonteremtési kedvezményről = Government Decree 17/2016 (II. 10) on the family housing allowance for the purchase or extension of a second-hand dwelling.

[26] See https://www.ksh.hu/stadat_files/nep/hu/nep0001.html

income families, while it reduced the opportunities for middle-income groups, which meant a social risk. Families with arrears and applicants who could not prove a sufficient length of employment were excluded from this subsidy.

Between 2016 and 2023, 251,000 families received CSOK subsidies, which was 22% of all transactions, with a total subsidy expenditure of HUF 609 billion, generating an additional HUF 1,342 billion in subsidized loans.[27] Thus, the CSOK scheme effectively contributed to the growth of outstanding loans but implied an increase in social risk by excluding significant groups from the housing support.

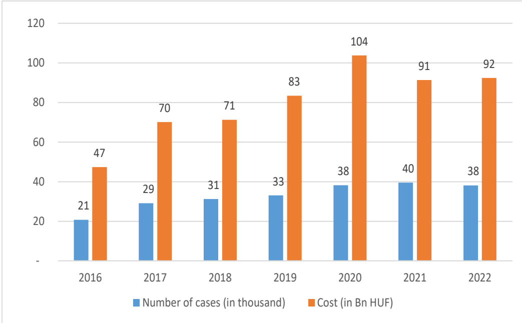

Figure 1 Number and sum of CSOK subsidies

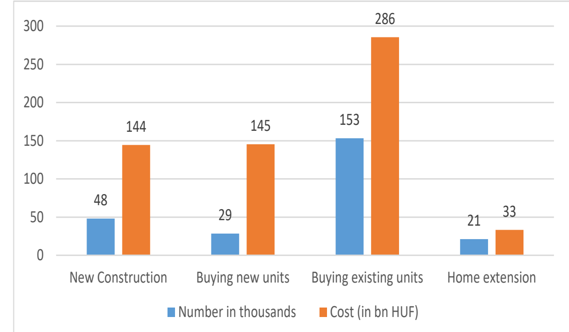

Figure 2 The use of the CSOK subsidies (number and the sum of the grant)

Source: Lakáshitelezés 2023 (Housing Loans) [28]

1.2. Childbirth Incentive Loan

A Childbirth Incentive Loan (CIL), not technically a home loan, can be used by families for anything, but surveys have shown that in 80 % of cases it is used to buy a home or replace existing loans. The childbirth incentive loan has been made available to young couples since July 2019. The scheme was originally planned to be phased out by July 2022, but the deadline has been removed and it has become a long-term subsidised loan scheme.

A loan of HUF 10 million is made available to married couples, the debt for which is cancelled fully upon the birth of their third child. The wife has to be maximum 40 years of age, and at least one of the married parties has to have paid social security contribution (i.e. held a legal job) for at least 3 years, of which at least for 180 days in Hungary. Public employment is also accepted up to 1 year out of the necessary 3. At the beginning of 2024, the maximum loan amount was increased to HUF 11 million, but the maximum age of the wife at the time the loan is granted was reduced to 30 years.

[27] Financial Stability Report 2024. Available at: https://www.mnb.hu/letoltes/financial-stability-report-may-2024-en.pdf

[28] Housing Loans of Households in 2023. Available at: https://www.ksh.hu/s/kiadvanyok/lakossagi-lakashitelezes-2023/index.html

The first child is expected to be born –or adopted– within five years; if this happens, the loan is interest free (except for a 0.5 percent 'guarantee fee'), and repayment is halted for three years. Upon arrival of the second child, another three-year halt is granted; and the loan is written off entirely upon the birth or adoption of the third child. If the couple is divorced or does not have children, they must repay their debt within 120 days with interest, but exemption is granted if they provide a medical certificate of their inability to have children. Most of the families belong the category of 'privileged costumers' of the banks (that is, high income, educated costumers).

At the end of 2023, the amount of the outstanding CIL was HUF 2,061 billion[29] and more than 235,000 couples took out the loan.[30] In the first two years, the stock rapidly increased but its growth has slowed down since the beginning of 2022.

In assessing the impact of the scheme, there is already a significant risk of default if children are not born within the specified period. The group most at risk are families who took out the loan between 2019 and 2021, as in their case the birth of the first child is already due or will be due soon. For them, the government has extended the deadline for the birth of the first child from 5 to 7 years. In addition, more than 1,000 families were already in arrears with their loan payments because of the high inflation period in 2022 and 2023.[31]

1.3 Village CSOK

The 'Village CSOK'[32] scheme was introduced in 2019 and was scheduled to run until June 2022, but has since been extended. Around 85%, roughly 3,150 municipalities in Hungary are small rural communities, although only around a third of the country's population lives in these municipalities. The regulation allows for the inclusion of 2,486 small settlements in the Village CSOK scheme, specifically those with a declining population of less than 5,000.

The programme is specifically designed for the purchase and renovation, modernisation and extension of dwellings on remote farms, estates or small settlements, to encourage the preservation and modernisation of rural areas.

[29] HNB, Trends in Lending, May 2024, Chart 10. Available at: https://www.mnb.hu/en/publications/reports/trends-in-lending/trends-in-lending-may-2024

[30] Egyre több család bajban a babaváró hitelesek közül (More and more families in trouble among baby loan borrowers). Article of Bankmonitor, 10 July 2024. Available at: https://bankmonitor.hu/mediatar/cikk/babavaro-hitel-hogyan-hat-a-most-bejelentett-valtozas-azokra-akik-felvettek/

[31] *Ibid.*

[32] 302/2023. (VII. 11) Korm. Rendelet a kistelepüléseken nyújtható otthonteremtési támogatásokról = 302/2023.(VII. 11) Government Decree on housing allowance grants in small settlements.

However, with the abolition of the CSOK scheme, significant were made in the Village CSOK scheme: the amount of the subsidies was increased and the purpose of the use of the subsidy was expanded in 2024. Currently, a maximum amount of HUF 15 million (approximately EUR 37,500) grant subsidy is available for constructing new single houses or for purchasing and renovating existing dwellings where parents have or plan to have 3 or more children. The lowest amount (HUF 600,000, i.e. approximately EUR 1,500) is available for one child if only renovation of an existing dwelling is involved; differentiation is made according to the type of transaction and the number of dependent or planned children, and one of the married partners must be under 40 years of age. Conditions also include the square meter footage, which depends on both the number of children and the intended purpose of the loan (purchase, building etc.). The claimant must have at least two years of social security entitlement and must not have a criminal record nor public debts.

As seen in Table 4, the rate of Village CSOK has drastically changed over the years.

Table 4 Composition of the total CSOK subsidies between 2016 and 2023

	Village CSOK (in bn HUF)	Home extension (in bn HUF)	Purchasing of used apartment (in bn HUF)	Purchasing of new apartment (in bn HUF)	Building of new apartment(in bn HUF)	Share of Village CSOK(%)
2016	0	23,2	10,6	31,9	65,7	
2017	0	25,1	23,2	38,2	86,5	
2018	0	27	25	31,5	83,5	
2019	22,2	20,5	27,4	32,3	102,4	22%
2020	61,5	20,7	18,6	20,5	121,3	51%
2021	57,6	27,1	20	22,1	126,8	45%
2022	49,9	20,3	21,6	20,5	112,3	44%
2023	27,1	15,5	8,8	7,9	59,3	46%
Total	218,3	179,4	155,2	204,9	757,8	29%

Source: Palkó, 2024[33]

1.4 CSOK Plus

A new subsidy has replaced the CSOK, named CSOK Plus.[34] Young families have access to soft loans with a maximum interest rate of 3 %. Upon the birth of the second child (and for each subsequent child), HUF 10 million of the outstanding loan debt

[33]Avalaible at: https://www.portfolio.hu/bank/20240626/bejelentest-tett-a-kormany-a-csok-pluszrol-es-a-falusi-csok-rol-694863

[34] Kormány rendelete a családok otthonteremtését támogató kedvezményes CSOK Plusz hitelprogramról 23.11.2023 (Government decree on the CSOK Plus loan programme to support families in creating a home 23 November 2023).

will be waived (so only children born during the term count). Families have to meet the following additional eligibility criteria: minimum 10% down payment, it should be their first flat, and one of the members of the couple has to have two years social insurance contract. The maximum amount of subsidised credit depends on the number of children: HUF 15 million for one child; HUF 30 million for two children; HUF 50 million, for three or more children. The value of the property must not exceed HUF 150 million. In the case of couples' first home, the purchase price and construction costs must not exceed HUF 80 million. Families must promise to have another or a first child in order to benefit from this support. Only married couples can apply for this benefit. The other criteria, such as the age of the wife, the existence of social security and the exclusion of couples with criminal record and public debt are same as in the case of Village CSOK.

In the first five months of its existence, banks received 6,000 applications for the CSOK Plus, which was launched on 1 January 2024, for the amount of HUF 160 billion, with couples applying for a loan of HUF 26 million on average. The preferential loan programme is therefore on track to meet the expectations of 12,000 contracts and over HUF 300 billion in applications for the whole year. As it is a loan, it must also comply with the bank's assessment rules.

2 Other New Considerations

2.1 Push to Regulate Housing Loan Interest Rate

On the 21th of October 2024, the Hungarian Government issued the New Economic Policy Action Plan (21 steps). Five of the 21 steps have an effect on the mortgage market. The most important is that the Ministry of National Economy asks banks to introduce a new voluntary APRC cap. Under the plans, the total interest rate of a residential mortgage loan should not exceed 5%. The 5% APRC ceiling is accompanied by an interest rate of around 4.7% (the remaining 0.3% is made up of other costs).[35] If banks accept that suggestion the available loan amount would increase by 14.8%. There is a debate among experts as to which of the banks will take the 5% maximum APRC and how the vestiges of this will be compensated. It is likely to lead to a rise in house prices, depending on the consumer group for which preferential rates are made available.

Furthermore, it is expected that the banks will marginalise lower income groups, for whom the risk of default is higher, and this will further reinforce the property subsidy effect of marginalising lower income groups.

[35] See https://bankmonitor.hu/mediatar/cikk/hogyan-hathat-az-ingatlanpiacra-az-5-os-onkentes-thm-plafon/

The government plans to allow employee benefits (the amount transferred to the employee's SZÉP card)[36] and amounts accumulated in a self-managed pension fund to be used for housing.

2.2 Green Loans

Because of the importance to increase green modernisation of the housing stock, the HNB considers changing the rules on the green loans from early 2025. The proposal is to increase the LTV to 90 % and oblige banks to lower the interest rate of green loans by 0.5%. The justification is the following. A green lending turnaround is needed, as the housing stock is not in a good shape: its heating energy consumption is high and decreasing only very slowly, with the total energy consumption per dwelling being the 6th highest in the EU and 30% above the EU average. Lending can play a key role in the green turnaround, but green home loans are in their infancy in Hungary, with no price differentiation between green and non-green loans. Green loans are currently concentrated in the upper income brackets, attracting a more conscious clientele, but requiring more equity and a more strained income burden.

2.3 Stop the Support for Housing Saving Banks

The government paid a premium of 30 % of the money saved for housing purposes up to HUF 72,000/year, at the eligible financial institutions. The condominiums and housing cooperatives could also take part in the scheme. After four years' saving, the households (and condominiums/coops) were eligible for low interest rate loans.

The savings had to be used for housing purposes (but after eight years' savings it was not a requirement). One family was allowed to have more than one contract (spouse, children etc). In 2018, the number of housing savings contracts was estimated at 1.3-1.5 million, while household surveys showed that only 6-7% of households had a housing savings fund contract. It was also estimated that most of the contracts belonged to the middle-class, while households belonging to lower- and upper-income groups were underrepresented in the scheme. However, the government had abolished the state premium in 2018.[37]

IV Conclusion

The Hungarian government, learning from the pre-crisis 'liberal' regulation, has taken very strong steps to introduce debt brakes in the spirit of the MCD. At the same time, its housing policy has been dominated by two important social/economic objectives:

[36] The SZÉP kártya (or SZÉP card) is similar to debit cards in appearance and in functioning. It is one of the forms of fringe benefits provided by employers. The amount on the SZÉP Card can be spent primarily for accommodation and related services in Hungary.

[37] Hegedüs (2018).

on the one hand, increasing the number of children, improving Hungarian ethno-population and achieving acceptable fertility rates; on the other hand, the credit-based economic policy has meant that credit demand has to be constantly ensured, as it is the engine of consumption, production and tax revenues. To this end, debt rules have been weakened at certain points and schemes to boost demand through non-reimbursable subsidies and subsidised loans at preferential rates have been introduced. Out of all loans issued between 2016 and 2023, 40% was subsidised, which placed a considerable burden on the government, especially when the interest rate went/goes up (such as in the years 2022 and 2023).

Table 5 The role of the subsidized loans (bn HUF)

Type of the loan	2016-2023	%
Market conditions	5 514	60%
CSOK subsidized loan	1 342	15%
CIL condition loan	2 368	26%
Total	9 224	100%

Source: Report on financial stability HNB 2024 May[38]

Moreover, the schemes have resulted in the exclusion of vulnerable groups, where higher value subsidies were linked to social parameters such as stable employment and a minimum high level of housing. In addition, conditions that would have excluded higher income groups from subsidies (such as the first housing condition, income thresholds) were removed and the value thresholds for subsidised housing were relaxed or eliminated. A direct consequence of this was that subsidies went to the top income groups, who took advantage of the opportunities to invest in housing essentially for 'speculation' purposes. This in turn led to a rapid increase in house prices, which devalued the subsidies and contributed even more to the decline in the middle classes.

Many of the programmes also have considerable risks associated with them. In the case of the CSOK, village CSOK, the childbirth incentive loan and CSOK Plus, the use of the subsidy is conditional on having a child, and failure to meet this condition entails significant costs; as a rule, those who do not fully meet the deadline to have children must repay the subsidy paid out plus interest on arrears in one lump sum. This can substantially increase the current and future payment obligations of the households concerned.

It is common for subsidies and subsidised loans to be used in combination with each other or with market credit, so that the increased payment burden and higher probability of default due to the failure to have children may also affect the household's further credit market products and participation. Default rates have been

[38] Chart 32. Available at: https://www.mnb.hu/kiadvanyok/jelentesek/penzugyi-stabilitasi-jelentes/penzugyi-stabilitasi-jelentes-2024-majus

calculated for CSOK subsidy and loan contracts signed between 2016 and 2018: depending on the type of subsidy, default rates range from 27 to 33 percent. Most of the defaults occurred because the expected children were not born. But is difficult to estimate the exact risk with these products.[39] This example illustrates that important risks may also arise in connection with the specific loan conditions, especially if they relate to future life events. Such risks may not be fully addressed by the foreseen creditworthiness assessments and the information provided to consumers.

Most of the policies also fail to account properly for the needs of the younger generation, who tend to marry and have children later and, with greater economic prosperity, often choose to have fewer children. Additionally, given the younger generation's acute vulnerability to the ongoing housing crisis, it is essential to implement programs that effectively address their housing needs.

Table 6 Characteristics of contracts that do not meet the condition on having children (based on June 2023 data)

	1 additional child						2 additional children		
	Contracts of 2016-2018 Deadline: 2020-2022			Contracts of 2019 Deadline: HPS: 2023 Prenatal baby support loan: 2024			Contracts of 2016 Deadline: 2024		
	per cent	pcs	HUF bn	per cent	pcs	HUF bn	per cent	pcs	HUF bn
HPS - max. 2 children altogether	33	4 195	8	38	1 579	2,8	57	705	1,3
HPS - min. 3 children altogether	27	787	8	34	342	3,4	42	45	0,4
Interest-subsidised HPS-loan	29	679	6	35	1 012	10,5	48	38	0,3
Rural HPS	-	-	-	27	179	1,1	-	-	-
Prenatal baby support loan	-	-	-	25	11 921	114,5	-	-	-

Source: Report on financial stability HNB 2024 May[40]

The Hungarian case demonstrates that Hungarian housing policy, similarly to the contemporary affordable housing policy in other New Member States, has failed to consider the basic principles of a) providing affordable rental for socially vulnerable groups and b) ensuring that better income groups cannot capitalise on subsidies. In order to decrease the housing crises, it is crucial to provide a predictable and affordable rental sector for social groups that are deprived of housing, and (this is particularly important in a country with a low social sector) the need for the state to target billions spent on housing to those in need, where need is to be understood in a broad sense. It is justifiable to provide property subsidies for lower-middle income groups and also to parts of the middle class, but only in a way that does not allow beneficiaries to capitalise on the subsidy individually. If a family has bought a home with serious public subsidies, and their financial situation allows them to move to a

[39] See Table 6.

[40] Box 5 Table 1. Available at: https://www.mnb.hu/kiadvanyok/jelentesek/penzugyi-stabilitasi-jelentes/penzugyi-stabilitasi-jelentes-2024-majus

better, bigger, more valuable home, they cannot receive the subsidy part of the value of the home, because that will allow another needy family to benefit from it.

Overall, the housing policy changes between 2015-2024 have led to a deepening of the housing crisis.

As a consequence of the 2008 crisis, and in implementation of the MCD rules, a comprehensive regulatory landscape has been established in Hungary. At the same time, the complexity of the regulatory framework and continuous modifications of the relevant national rules have affected financial awareness of consumers despite the information measures undertaken.

The granting of subsidised (mostly mortgage) loans for childbearing builds a conditional liability into the system, as it encourages the adoption of a child, the future costs of which are unknown, and depending on the evolution of various conditions, may lead to financially unfulfilling situations. In this respect, the situation is analogous to that of foreign currency lending, where the borrower assumes the exchange rate risks, whereas in the Hungarian schemes the state transfers the risks of childbearing to families in exchange for short-term benefits.

Experiences have also shown that in lack of an efficient social housing system and adequate regulatory safeguards in other fields (such as in the field of tenancy law), the focus on subsidised mortgage loans has contributed to deepen the housing crisis. The exclusion of more vulnerable groups, the inclusion of higher income groups, and the increased risks in some programs for more vulnerable families have negative implications for the Hungarian housing situation.

Considering these impacts in a broader perspective, as part of EU housing policy measures, would be of high added value.

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CHAPTER 6
REGULATION OF MORTGAGE LENDING AND THE IRISH HOUSING CRISIS
FROM MORTGAGE 'ARREARS' TO HOUSING 'UNAFFORDABILITY'

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I Introduction

For well over a decade, Ireland has been beset by an acute housing crisis. The flagship government housing policy document, *Housing For All* (2021) begins with the stark recognition that 'Ireland's housing system is not meeting the needs of enough of our people'.[1] The scale and persistent nature of the problems has led the President of Ireland to go further and describe the housing situation not as a crisis, but as a 'housing disaster'.[2] While this has its roots in the 2008 financial crisis, the nature of the housing crisis has changed significantly over the past decade. In contrast to the 2008 crisis, which was largely driven by irresponsible lending and mortgage arrears,[3] the present crisis is much broader in nature and is characterised by extraordinary levels of unaffordability, affecting both ownership and private renting, insecurity, and rising homelessness.

Residential mortgage lending is vitally important to understanding both the 2008 crisis of mortgage arrears and the present affordability crisis. There are ongoing debates in Ireland about state housing policy and the regulation of residential lending.[4] These debates reflect how the Irish mortgage market has undergone significant changes over the past decade. Major retail lenders have exited the market, frequently offloading their loan portfolios to non-bank lenders and, so called, 'vulture funds', leaving thousands of consumers unable to switch from highly expensive credit arrangements.

There have also been changes in the types of mortgage loans offered by lenders. So called, green mortgages now account for a third of all residential mortgage lending.[5] However, as presently designed, such loans have been criticised as a form of 'green washing' which confers benefits on higher income groups, thereby exacerbating existing housing inequalities. Although the regulation of residential mortgage lending has undergone extensive reform over the past decade, recent developments and scandals have exposed various gaps in the regulatory and consumer protection framework which the recast Mortgage Credit Directive (MCD) could help to address.[6]

This chapter outlines the present housing situation in Ireland and seeks to identify gaps and weaknesses in the consumer protection framework that could be addressed by reform involving the recast MCD. In section II, it outlines how the nature of the Irish housing crisis has changed since 2008, from a crisis of arrears to a crisis of

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[1] Department of Housing, Local Government and Heritage, *Housing for All – a New Housing Plan for Ireland* (2021) 16.

[2] See https://www.irishmirror.ie/news/irish-news/politics/president-michael-d-higgins-lays-27233023.

[3] For a more detailed discussion of the role of residential mortgage lending in the rise and eventual collapse of the housing market in Ireland in 2008 see Jordan (2017) 274-299.

[4] See https://www.theguardian.com/commentisfree/2023/dec/11/ireland-housing-crisis-far-right-europe-refugees

[5] Lambert, Lyons & Carroll (2023) 1.

[6] See https://www.thejournal.ie/readme/mortgage-prisoners-6064001-May2023/

unaffordability. In section III, it outlines the core features of the regulation of mortgage lending in Ireland to contextualise and explain recent important legal and policy developments. This context is also important because, as a common law system, Irish mortgage law is distinctive to most other Member States. The final section reviews the operation of the MCD in light of recent changes in the Irish mortgage market and associated legal developments.

II From 'Arrears' to 'Unaffordability': The Changing Dynamics of the Irish Housing Crisis

One of the striking features of the Irish housing crisis is the marked decline in rates of home ownership which has fallen from 79% in 1991 to 66% in 2022.[7] The decline has been particularly acute among younger people and lower income groups – with less than a third of 30 year olds owning their home.[8] This trend has been driven by acute house price inflation before, and following, the collapse of the housing market in 2008 which has greatly exceeded wage increases during this period.[9] Average house prices nationwide are now almost eight times the national average wage and in Dublin, they are approximately 10 times the average wage.[10] As discussed in the next section, the Central Bank of Ireland has responded to the recent acute house price inflation by introducing mortgage measures that set limits on both loan to value and loan to income ratios.

Acute house price inflation has significant consequences for those that purchase with a mortgage. Average interest rates on new mortgages in Ireland are amongst the highest in the eurozone.[11] Thus, many recent purchasers with a mortgage, particularly first-time borrowers, face higher costs of repaying their mortgage than their EU counterparts. The unaffordability of housing extends to the rented sector where since 2015, rents have increased by 60% as compared to just 13% across the euro area.[12] The affordability crisis is particularly acute in Dublin where the average monthly private rent is €2,400.[13] The scale of the affordability crisis is such that a majority of the Irish population (85%) would now welcome a decline in house prices.[14]

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[7] Central Statistics Office, *Census of Population 2022 Profile 2 – Housing in Ireland* (2023).
[8] Dish & Slaymaker (2023) 16.
[9] Houses of the Oireachtas, *Housing Affordability for Private Household Buyers in Ireland* (2023) 3.
[10] See https://www.thejournal.ie/housing-prices-report-5959486-Jan2023/
[11] See https://www.irishexaminer.com/business/economy/arid-41266243.html
[12] See https://ec.europa.eu/eurostat/databrowser/view/PRC_HICP_AIND__custom_1514466/bookmark/map?lang=en&bookmarkId=3c1146e5-a59d-42e4-8d13-a6625c98b7db
[13] See https://www.dublinlive.ie/news/dublin-news/average-rent-soars-2400-dublin-29202305
[14] See https://redcresearch.ie/wp-content/uploads/2022/05/Business-Post-RED-C-Opinion-Poll-Report-May-2022-1.pdf

Housing insecurity is another striking feature of the housing crisis. This is particularly apparent in the private rented sector where approximately one in ten of every renting household were served a notice of termination to end their tenancy in the past three years.[15] In the last decade, according to state statistics, Ireland has 'gone through one of the most rapid increases in homelessness recorded anywhere, except in cases of natural disaster or war'.[16] In October 2023, the government records that approximately 13,000 people were accessing emergency accommodation in Ireland.[17] The numbers in emergency accommodation do not capture the extent of the homelessness crisis in Ireland. When one takes into account the numbers living in precarious housing, i.e. housing which is unaffordable, insecure, over-crowded, unsuitable or unfit, there may be as many as 75,000 people experiencing homelessness.[18]

Unsurprisingly, housing has become a major concern for the Irish public. In 2023, 61% of people in Ireland identified housing as one of the two most important issues facing the country (as compared to just 10% of people across the EU).[19] Political tensions around housing have increased the longer the crisis has endured. Recently, the housing crisis has been 'weaponised' by the far right in campaigns against immigrants, asylum seekers and refugees.[20] In this context, there are ongoing highly politicised debates in Ireland concerning how the crisis could be resolved through reforming regulation of mortgage lending, expanding rent control, building more public housing, and constitutionalising a right to housing.[21]

The government, property developers and many economists tend to explain the present housing crisis as a problem of inadequate housing supply. Government housing policy has mainly sought to increase the supply of housing by reforming zoning and planning systems and increasing funding for construction of social and affordable housing for purchase or rent.[22] In addition, a wide range of direct and

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[15] Residential Tenancies Board (RTB), *Notices of Termination (NoTs) received by the RTB, Q2 2019 - Q2 2022* (2022).

[16] Baptista, Culhane, Pleace & O'Sullivan (2022) 8.

[17] See https://homelessnessinireland.ie/#:~:text=Homelessness%20is%20an%20issue%20experienced,accessing%20emergency%20accommodation%20in%20Ireland

[18] See https://www.theguardian.com/commentisfree/2023/dec/11/ireland-housing-crisis-far-right-europe-refugees

[19] See https://europa.eu/eurobarometer/surveys/detail/3052

[20] Houses of the Oireachtas, *Report on Refugees and Integration* (2023) 34.

[21] See https://www.independent.ie/irish-news/referendum-on-housing-unlikely-to-happen-during-this-government/a2112080982.html

[22] Department of Housing, Local Government and Heritage, *Housing for All – a New Housing Plan for Ireland* (2021) 23-24.

indirect supports including tax reliefs, local authority loans and shared equity schemes have been introduced to arrest and reverse the decline in ownership rates.

However, others have traced the present crisis to policies adopted by successive Irish governments since the 1980s involving shifts towards the privatisation of public rented housing, deregulation of mortgage lending and private renting, and the marketisation of home ownership. They contend that such policies have promoted the financialisation of housing and prioritised the commodity value of housing over its social function as a home.[23] Rory Hearn argues that the 2008 crisis did not lead to a transformation of this pre-crisis housing model rather 'the policy adopted to achieve economic 'recovery' included pushing up property prices so that the asset value of housing held on banks' balance sheets would rise again, making banks solvent, and recovering the investments of Celtic tiger developers'.[24]

III Overview of the Regulation of Mortgage Lending in Ireland

The ongoing housing crisis in Ireland has led to increased public debate about the regulation of residential mortgage lending in Ireland. This debate has been shaped by the 2008 financial crisis, which exposed the limitations of the legal framework governing residential mortgage lending and the neoliberal assumptions underpinning that framework. As the crisis unfolded, it became clear that the legal framework had done little to prevent the widespread irresponsible residential mortgage lending which was at the heart of the crisis.[25] A raft of reforms to the regulation of residential mortgage lending were introduced in response to the 2008 crisis. More recently, there have been further reforms of this framework in response to the growing unaffordability crisis.[26] In order to explain these reforms, it is necessary to first outline some important features of the legal framework governing residential mortgage lending in Ireland.

1 Housing Loans and Mortgages

Residential mortgage lending is subject to a patchwork regulatory regime that is composed of distinct sets of rules and principles emanating from a wide variety of sources. The current framework comprises elements drawn from substantive land law,

[23] See Hearne (2020) 107-131.
[24] See https://www.theguardian.com/commentisfree/2023/dec/11/ireland-housing-crisis-far-right-europe-refugees
[25] Dübel & Rothemund (2011) 17, 18 and 24.
[26] Kenna (2011) 35-55.

contract law, consumer protection regulations, statutory (and industry) codes of conduct as well as policy instruments.[27]

The concept of 'Housing loans' is a central organising concept within this framework and is defined broadly as 'an agreement for the provision of credit to a person on the security of a mortgage of a freehold or leasehold estate or interest in land'.[28] They include agreements where the loan is made for the purpose of enabling the consumer to purchase, construct or improve their principal residence as well as refinancing agreements.

Housing loans are understood as a particular form of mortgage. Thus, the lender and borrower are subject to the general statutory regime that governs the parties powers and obligations in relation to the mortgage agreement.[29] The statute provides lenders with extensive statutory powers of enforcing the security including the right to apply to the court for an order of possession and/or an sale in the event of default.[30] There have been significant recent reforms of the lenders powers of enforcement and these are discussed in relation to forbearance measures in section 3 below.

2 Consumer law protections

Housing loans are designated as a special form of mortgage credit and are subject to a distinct regulatory regime which provides for a range of additional protections. This regime is composed of two distinct branches comprising consumer law protections and the regulation of financial services. The consumer law protections largely stem from the Consumer Credit Act 1995 which transposes the Consumer Credit Directive (i.e. Directive 87/102/EEC) and imposed obligations on 'housing loans' made by a mortgage lender. The consumerist approach is apparent in how the legislation seeks to ensure transparency regarding the main terms, costs and charges, imposes mandatory disclosure requirements on lenders and sets restrictions on permissible conduct of business practices, e.g. prohibitions on early redemption fees.[31]

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27 Kenna (2011) 441-487; Wylie (2010) 745-838.

28 Consumer Credit Act 1995, s. 2(1).

29 Land Conveyancing and Law Reform Act 2009, s. 3 defines a 'mortgage' to include any charge or lien on any property for securing money or money's worth. The statutory powers tend to be restated in the mortgage contract.

30 Land Conveyancing and Law Reform Act 2009, ss 97, 100.

31 Consumer Credit Act 1995, ss 121, 123 and 125.

3 Regulation of Financial Services

The second branch of this regime stems from consumer protection codes issued by the Central Bank of Ireland as part of its mandate to regulate financial services.[32] Prior to the financial crisis, the Consumer Protection Code 2006 imposed principle-based conduct of business obligations on lenders. Following the financial crisis, this code was replaced by the Consumer Protection Code 2012 which imposed a more 'prescriptive' set of conduct of business obligations on housing loan providers including information-based obligations, product suitability requirements and obligations on lenders to gather prescribed minimum information standards from the consumer to facilitate an appropriate product recommendation.[33]

Lenders are required to conduct an affordability assessment to ascertain the personal consumer's likely ability to repay the debt over the duration of the agreement'.[34] In making this determination, the lender must consider the personal and financial information gathered, and ensure stress testing of the interest rate. In order for a lender to make any further extensions of credit to a personal consumer, they must conduct additional affordability and suitability assessments.[35]

4 Transposition of the MCD

The regulatory framework governing residential mortgage lending was extended when the MCD was transposed by the European Union (Consumer Mortgage Credit Agreements) Regulations 2016 (the Regulations). This provides, amongst other things, for a mandatory creditworthiness assessment of borrowers, pre-contractual conduct of business requirements and provisions relating to arrears and foreclosure. Unlike in the UK where the MCD was integrated into the existing mortgage conduct of business rules, in Ireland the regulations co-exist alongside the CPC 2012. A detailed account of the transposition of the MCD can be read elsewhere.[36]

5 Macro-Prudential Mortgage Measures

In response to the acute housing price inflation since 2013, the Central Bank of Ireland introduced a range of macro-prudential measures in 2015 aimed at restricting risky lending and dampening property price speculation. These measures have set limits on

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[32] See Lynch Shally (2020) 138-139.
[33] Lynch Shally (2020) 134-135.
[34] Consumer Protection Code 2012, ss 5.9 to 5.15.
[35] Consumer Protection Code 2012, s.5.15.
[36] Jordan (2017) 274-299.

both loan to value and debt to income ratios and have faced popular opposition for failing to constrain house price inflation while making it more difficult for borrowers, particularly first-time buyers, to access mortgage finance.

In 2022, the Central Bank of Ireland conducted a review of these measures. It found that persistent house price inflation since 2013 reflected 'underlying structural challenges in the house market' including in particular the 'ongoing imbalance between the demand for, and supply of, housing'.[37] However, it contended that such challenges are 'best addressed by policies that focus on the level and composition of the supply of housing' and that the 'mortgage measures are not a policy lever that can address underlying housing supply challenges'.[38]

Indeed, it concluded that the measures had effectively guarded 'against growth in high levels of indebtedness and unsustainable lending in the housing market' and that they ensured that 'the economy as a whole is in a better position to withstand adverse shocks than in the past, including shocks stemming from interest rate increases or cost of living pressures'.[39] Following a consultation, the Central Bank decided to recalibrate the measures. This has involved the relaxation of the loan to income ratio for first time buyers from 3.5 to 4 times income and the redesignation of the category of first-time buyers to enable borrowers who are divorced or separated or have undergone bankruptcy or insolvency to be considered first time buyers.[40]

IV Reviewing the MCD in Light of Developments in Ireland

1 Considerations on the Scope of the MCD

The Irish mortgage market has undergone significant changes since the financial crisis. These changes involve the rise of new market actors, namely non-bank lenders, vulture funds, and the increased prominence of forms of mortgage lending that fall outside the MCD. These developments raise challenging regulatory issues and reveal significant gaps in the consumer protection framework.

[37] Central Bank of Ireland, *The Central Bank's framework for the macroprudential mortgage measures* (2022) 3.
[38] Central Bank of Ireland, *The Central Bank's framework for the macroprudential mortgage measures* (2022) 4.
[39] Central Bank of Ireland, *The Central Bank's framework for the macroprudential mortgage measures* (2022) 4.
[40] Central Bank of Ireland, *The Central Bank's framework for the macroprudential mortgage measures* (2022) 5-6.

1.1 The Rise of Non-bank Entities and, So Called, Vulture Funds

In recent years, there has been a dramatic increase in the role of non-bank lenders in Ireland. The Central Bank of Ireland found that such lending had grown considerably from just 3% of in 2018 to 13% of new lending 2021.[41] This has been explained as stemming from three broad factors including monetary policy, i.e. low interest rates have led investors to search for greater yields, developments in information technologies, and market reactions to post-crisis regulatory reforms of the banking system.[42] While these factors are important, it is also the case that this development has been largely driven by growing portfolio sales by Irish retail banks to specialist investors (i.e. vulture funds) of non-performing loans issued before the financial crisis.[43] This was encouraged by the Irish Government and the European Central Bank (ECB) as a means of reducing the numbers of non-performing loans held by Irish lenders.[44] As a result, 60,000 residential mortgage loans (most of which are performing) with Irish retail banks were sold to, so called, 'vulture funds'.[45]

Although the Government assured consumers that they would not suffer any adverse impacts from such transfers, many thousands of consumers have become 'mortgage prisoners' and are locked into paying a much higher mortgage rate, raising the risk of arrears and default. Many of these consumers were given 100% mortgages or, since obtaining the loan, their financial circumstances have changed through divorce, illness or unemployment. These consumers end up paying higher repayments because, unlike the main retail lenders, the vulture funds holding their mortgage do not offer fixed-rate mortgages.[46] In such cases, consumers are trapped because they cannot switch to lower repayments with other retail lenders because they would not pass the creditworthiness assessment, despite currently managing to make the higher repayments with their current lender.[47]

The EU Directive (EU) 2021/2167 on credit servicers and credit purchasers, which was transposed into Irish law from 30 December 2023, does little to address the problems facing current 'mortgage prisoners'. The Directive aims to foster the development of a secondary market for non-performing bank loans by setting out a common framework for the transfer and management of such loans which are transferred or sold after transposition. The Directive amended the Mortgage Credit

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[41] Gaffney, Hennessy & McCann (2022) 1.
[42] Gaffney, Hennessy & McCann (2022) 3.
[43] Gaffney, Hennessy & McCann (2022) 2.
[44] Hearne (2020) 139-140.
[45] See https://www.thejournal.ie/readme/mortgage-prisoners-6064001-May2023/
[46] See https://www.thejournal.ie/readme/mortgage-prisoners-6064001-May2023/
[47] See https://www.independent.ie/business/personal-finance/central-bank-fast-asleep-over-plight-of-mortgage-prisoners/a703412853.html

Directive to require creditors to adopt and maintain adequate policies and procedures and adopt reasonable forbearance procedures before initiating default enforcement proceedings in relation to non-performing loans. However, these protections do not apply to the sale of performing or non-performing loans which took place before the transposition of the Directive.

Furthermore, those protections do not adequately address the problems that arise where loans are sold or transferred to 'vulture funds' that adopt commercial practices that are prejudicial to those consumers. In Ireland, the majority of 'mortgage prisoners' involve the transfer or sale of loans that are performing but involve very high costs. It seems perverse that under the Directive consumers must first enter arrears to trigger engagement with the lender under the forbearance requirements. This is arguably too late, and the delay will generate greater costs and risks for consumers, many of whom are economically vulnerable.

It would be much better if the Directive imposed a requirement that creditors proactively engage with borrowers and must ensure they are not prejudiced by any sale or transfer of the loan.

Aside from the risks posed to consumers, non-bank entities also pose wider potential financial and economic risks. While regulations governing financial conduct and consumer protection may apply to such entities, they do not take deposits and so are not subject to international regulatory capital requirements. Furthermore, their loans are not subject the risk-weighted asset regime, which 'may affect their appetite to take risks'.[48] Finally, many non-bank entities rely on market-based funding sources, which involves more volatile funding costs.[49]

1.2 Crowdfunding Service Providers

One of the more novel recent developments is the small but growing number of Crowdfunding Service Providers operating in Ireland, some of which specialise in facilitating secured funding of real estate projects. Where such entities fall within the definition of a crowdfunding service provider, they must receive authorisation from the Central Bank of Ireland to provide these services. The relevant legislation, Regulation (EU) 2020/1503, defines the terms 'crowdfunding service provider' and 'crowdfunding services', sets standards, and governs the authorisation process.

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[48] Gaffney, Hennessy & McCann (2022) 6.
[49] Gaffney, Hennessy & McCann (2022) 4.

The Crowdfunding Service Providers which specialise in real estate projects in Ireland generally facilitate secured lending to commercial entities including property developers and approved housing bodies to undertake residential construction projects.[50] In such transactions, the borrower would apply for a loan from the Crowdfunding Service Providers. The application would be reviewed by the Crowdfunding Service Provider's property team, and this involves due diligence including credit checks on the borrower and directors, validation of projected costings and valuations. Once the loan request is approved, the Crowdfunding Service Provider takes the first legal charge (i.e. mortgage) over the property and then advertises the 'investment' on the platform to the 'community of lenders'. At the end of the loan term, which is typically between 1-3 years, the 'lenders' initial investment and interest payments are paid to their account.[51] The Central Bank has indicated that Crowdfunding Service Providers are subject to the Consumer Protection Code 2012.[52]

To date, Crowdfunding Service Providers do not facilitate mortgage lending, involving the provision of 'housing loans', directly to consumers. Their main form of borrowers are property developers and charitable bodies, namely Approved Housing Bodies, and neither would constitute a 'consumer' for the purpose of the Mortgage Credit Directive.[53] If Crowdfunding Service Providers start to facilitate loans directly to consumers, this would raise challenging regulatory questions. Under the MCD, the task of determining whether a borrower is a 'consumer' falls to the lender. However, Crowdfunding Service Providers straddle the line between lender and credit intermediary/broker. In some respects, they function as a conventional lender, i.e. loan origination, conducting due diligence, and securing the legal charge over the borrower's property, but they do not finance the loan, which instead is raised from investors via their online platform.

1.3 Forms of Lending Exempt from the MCD

The Irish government exercised its discretion under Art. 3 of the MCD to exempt local authority mortgages as well as equity release mortgages from the scope of the MCD. In the first case, local authority mortgages have long been provided under a separate statutory framework (i.e. the Housing Acts 1966-2021), which falls under the remit of the Department of the Housing, Local Government and Heritage. However, such loans are also governed by the Consumer Credit Act 1995, in much the same way as

[50] See, for instance, https://www.propertybridges.com/

[51] This account is based on the commercial practices adopted by Property Bridges see https://www.propertybridges.com/how-it-works/.

[52] Central Bank of Ireland, *Regulation (EU) 2020/1503 on European crowdfunding service providers for business Questions and Answers* (2024).

[53] Gaffney, Hennessy & McCann (2022) 1.

other 'housing loans'. Thus, it was not clear on what basis the decision was made to exclude local authority loans from the remit of the MCD.[54]

Historically, local authorities have played a considerable role in providing loans to consumers for the purchase of housing. More recently, the government have expanded the lending role of local authorities by introducing the Local Authority Home Loan scheme in 2022 as a policy response to the growing unaffordability of home ownership. This scheme involves a government-backed mortgage provided by local authorities that is available to first time buyers and fresh start applicants.

The loan can provide up to 90% of the market value of the property and can be used to purchase a new or second-hand property or for self-build. Under the scheme, interest rates are fixed for the full term of the mortgage, i.e. 25+ years. Accessing a loan depends upon meeting the eligibility and creditworthiness requirements which are assessed by the local authority's credit committee. Applicants must demonstrate that they have received insufficient mortgage offers from two regulated mortgage providers to be eligible to apply for the Local Authority Home Loan.

Given that local authority mortgages and the Local Authority Home Loan scheme are targeted at lower income households that are unable to access financing from the general mortgage market, the decision to exclude such 'consumers' from the protections under the MCD appears difficult to justify.

The Irish government also excluded equity release mortgagees from the scope of the MCD. Equity release schemes come in two forms –home reversion schemes and equity release schemes. A home reversion involves a sale of part of the value of the property and leads to a co-ownership arrangement rather than a mortgage type transaction. By contrast under an equity release scheme the borrower, usually an elderly person, takes out a mortgage over their home or part of the value of the dwelling to release some equity from their home. The loan is not repaid until the borrower permanently moves out or dies, so it grows over time as interest is added to the balance. Thus, such products offer very poor value for money due to the way in which compound interest applies to the loan.[55]

The decision to exclude equity release schemes, represented a departure from existing practice in Irish law where such mortgages are treated as 'housing loans' for the purpose of the Consumer Credit Act 1995.[56] The exclusion seems even more difficult

[54] Consumer Credit Act 1995, s. 3 (a)-(b).
[55] See https://www.centralbank.ie/docs/default-source/publications/discussion-papers/discussion-paper-10/age-action-ireland---response-to-dp10.pdf?sfvrsn=f13f9f1d_2 (last visited 06.03.2024).
[56] Consumer Credit Act 1995, s. 2(c).

to justify given the characteristics of this borrowing arrangement. In the past such mortgages were often conditional upon the borrower making a will and disclosing completely sensitive information about beneficiaries, etc. Furthermore, many borrowers in this market have tended to be elderly persons, some of whom may be vulnerable.[57]

2 Information Rights and the Challenges of Digitalisation

There are considerable benefits to ensuring that consumers are provided with clear and straightforward information about mortgage products prior to the conclusion of the contract. The European Standardised Information Sheet (ESIS) represented a valuable development because, in theory, it enables consumers to compare different mortgage products and choose the mortgage product that is most suitable to their needs. The regulatory assumption underpinning the provision of this form of standardised information to consumers is that it would lead to better individual borrower decisions, encourage competition between mortgage lenders, and produce safer lending outcomes in aggregate. However, the limitations of such regulatory assumptions were exposed during the 2008 financial crisis, while more recently changing consumer and lender behaviour and developments in digitalisation present further challenges to the effectiveness of the ESIS.
Irish banks adopted the European Voluntary Code of Conduct for Pre-Contractual information on home loans in the early 2000s. Despite being widely implemented, it did little to curtail the irresponsible lending decisions and over indebtedness by borrowers that precipitated the economic crisis of 2008. In practice, borrowers, particularly those in the sub-prime market, often did not compare mortgage products or understand important features of the mortgage product. As Sarah Nield points out borrowers' decisions to take a mortgage may not be entirely rational and indeed are often influenced by emotional factors.[58] In particular, borrowers may be 'over optimistic' in their assessment of risk, and they often focus on the property purchased and simply see the mortgage as a means to an end rather than as a product itself.[59] Such attitudes are likely to still influence consumer borrowing decisions in Ireland. As noted earlier, private renting is highly expensive by international standards, and this creates considerable economic pressure to exit the rental market by purchasing a property with a mortgage.

The effectiveness of the ESIS is also limited because it tends to be provided to consumers too late in the mortgage application process, i.e. after an offer of a mortgage product is made by the creditor. At this stage of the process, the consumer may already

[57] Lydon & O'Hanlon (2012) 1-5.
[58] Nield (2010) 610.
[59] Nield (2010) 610.

be committed to a particular product and there is less time for them to examine other mortgage products that might be more suitable to their needs. It would be a positive development if the ESIS provision was obligatory before the provision of an offer that was binding on the lender. Finally, recent developments in digitalisation and changing consumer behaviours have also exposed the limitations of the ESIS. Many consumers access mortgage information via banking apps through their smart phones. The ESIS does not easily translate into digital mediums and there appears to be a need for a simplified form of the ESIS that could be provided via digital mediums.

3 Foreign Currency Mortgages

When the MCD was being transposed into Irish law, there were concerns that the provisions of the directive relating to foreign currency loans would cause lenders to withdraw from mortgage lending to those earning foreign currency out of concern about the increased administrative costs associated with offering such loans.[60] Although the Central Bank of Ireland sought to reassure borrowers that banks would remain free to consider applications for a foreign currency mortgage, it appears that the transposition of the MCD has reduced the ability of consumers to access foreign currency mortgages in Ireland.[61]

This is a particularly significant issue in Ireland where the Republic of Ireland shares an open land border with the United Kingdom. While nationals of both the Republic of Ireland and the United Kingdom can live in one state but work in the other, the frequency of this cross-border activity is particularly associated with Northern Ireland. It is common for nationals of the Republic of Ireland to live in the Republic but work and earn income in the North and vice versa. In such cases, households working in Northern Ireland are paid in sterling but may well take out a mortgage in the Republic of Ireland, where they live, in euros.

While foreign currency mortgages continue to be available in Ireland, they are much more difficult to access for two reasons. Firstly, there are only a small number of lenders providing this type of mortgage in Ireland.[62] Secondly, for those lenders that do provide foreign currency loans, they typically discount up to 20% of the gross income of the borrower or borrowers when assessing the loan application. This will have a significant impact on the amount of lending available to the borrower given macro prudential limitations on loan to value and loan to income rations in Ireland and the UK. Such measures appear to have been adopted to limit the exchange rate

[60] See https://www.thejournal.ie/mortgages-northern-ireland-republic-2781808-May2016/.
[61] See https://www.thejournal.ie/mortgages-northern-ireland-republic-2781808-May2016/.
[62] See https://advicefirst.ie/mortgages-advice-centre-donegal/mortgages-when-earning-sterling/.

risk to which the consumer is exposed under the credit agreement, which is a requirement under the MCD.

4 The Rise of Green Mortgages

Green mortgages were introduced by lenders in Ireland in 2019 and they are now offered by most mortgage lenders. There is no legal definition of green mortgages and instead they have been identified through existing loan characteristics and, in particular, through the interest rate discounts they provide to consumers.[63] Despite their recent introduction, the Central Bank estimates that such loans account 'for a sizable and growing share of mortgage lending', and in 2022 accounted for about a third of residential mortgage lending.[64] Green mortgages offer borrowers lower interest rates where they purchase housing that has a high energy efficiency rating, i.e. it is B3 or above on the Building Energy Rating (BER) labelling system. On average, the interest rate charged on green mortgages is 0.3 percentage points lower than non-Green Mortgages.[65] This provides an incentive for borrowers to invest in more energy efficient housing and thus offers a means of helping to meet Ireland's wider decarbonisation goal of reducing building emissions by 40% by 2030.[66]

In practice, green mortgage loan amounts tend to be larger, involving higher loan to value and loan to income, which reflects how they tend to be associated with newly built and more expensive properties.[67] Furthermore, green mortgages are more prevalent in higher income groups and uptake is much lower among low-income borrowers. Given that lower income borrowers are 'more vulnerable to climate-related energy price rises and are less likely to be in a position to invest in technologies that help mitigate energy usage', green mortgages may well exacerbate existing inequalities within the housing system.[68] It has been argued that green mortgages involve an element of greenwashing as they do not refer to 'some type of loan that's backed by environmental initiatives or carbon offsetting schemes'.[69] Furthermore, given that all new residential dwellings (houses or apartments) in Ireland already must have a Building Energy Rating (BER) of A2, green mortgages may well have greater decarbonising impacts if they were more widely available and offered additional

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[63] Lambert, Lyons & Carroll, (2023) 3.
[64] Lambert, Lyons & Carroll, (2023) 1.
[65] Lambert, Lyons & Carroll, (2023) 1.
[66] Government of Ireland, *The Climate Action Plan 2023* (CAP23) (2023) 160-182.
[67] Lambert, Lyons & Carroll, (2023) 7-8.
[68] Lambert, Lyons & Carroll, (2023) 8.
[69] See https://www.irishexaminer.com/business/economy/arid-41141212.html#:~:text=Most%20green%20mortgages%20are%20available,%2C%20movers%2C%20and%20switchers%20alike.&text=A%20research%20note%20released%20by,a%20third%20of%20mortgage%20lending

discounts where the borrower brought about energy efficiency improvements in older housing.

5 Early Repayment

In Ireland, lenders typically allow consumers to overpay their fixed rate mortgage up to certain limits –usually 10% each year– without incurring an early repayment fee.[70] However, where consumers have sought to repay a fixed interest rate mortgage early, there appears to be deviations in the calculations of compensation undertaking by lenders in Ireland. This has been acknowledged by the Central Bank of Ireland but there has not been any guidance issued to address this problem and instead the Central Bank has deferred to the European Banking Authority on this matter.[71]

Under the Regulations transposing the MCD, consumers have a right to fully or partially repay their mortgage loan early. Where they avail of this right, they are entitled to a reduction in the total cost of the loan, i.e. both interest and the costs for the remaining duration of the contract. However, in such cases, the lender is entitled to 'fair and objective compensation, where possible, for possible costs directly linked to the early repayment' but is not allowed to impose a sanction on the consumer. In all cases, the compensation must not exceed the financial loss to the creditor.[72]

When transposing the Directive, Ireland did not avail of the discretion to set limits on the amount of compensation or the period for which it is allowed. Under the Regulations, compensation is only permitted where the borrowing rate provided in the mortgage:

- may not be changed or
- may not be changed over a period of at least one year or
- is capped, for at least 5 years, at a rate no greater than 2% above the interest rate that applies on the date of the agreement.

Under the Regulations, lenders must follow five criteria when imposing an early repayment charge. In particular, the compensation must be fair and objective, justified, must be for possible costs directly linked to the early repayment, must not

[70] See https://www.independent.ie/business/personal-finance/top-tips-paying-off-fixed-mortgage-early-could-trigger-hefty-fee/40607801.html.
[71] Central Bank of Ireland, *Correspondence with Deputy Michael McGrath TD re breakage fee methodology for fixed-rate mortgages* (2018) 1-9.
[72] European Union (Consumer Mortgage Credit Agreements) Regulations 2016, SI no. 142 of 2016, regulation 26(2).

exceed the financial loss of the creditor and must not impose a sanction on the consumer.

The critically important term is what constitutes 'financial loss'. To date, the Central Bank of Ireland has not issued any guidance on how that term should be interpreted. When asked about this issue, it has explained that it defers to the European Banking Authority and that 'any such guidance would more appropriately be issued at a European level given that the aim of the Directive is to harmonise consumer protection'.[73]

Concerns about deviation in the calculation of early repayment charges amongst Irish were raised with the Central Bank. It responded by explaining that any such deviation could be due to 'the cost to the lender of adjusting the funding in place for that mortgage (or portfolio of mortgages)' and that 'Lenders typically fund lending activities in a variety of ways, including for example, customer deposits, wholesale market deposits and bonds. The cost of these sources of funding will vary from one funding source to another; from one lender to another (depending on the credit rating of the lender, for example); and also over time in response to market changes'. It also pointed out that 'a lender may engage in interest rate hedging for fixed interest rate mortgage lending including, for example, by entering into Interest Rate Swaps'.

Thus, the Central Bank attributes deviation in early repayment charges to commercial factors which mean that 'the lender may incur a cost of adjusting the funding source or any Interest Rate Swap entered into'.[74] While such commercial factors are relevant, there is arguably more that both the Central Bank and the lenders could be doing to help consumers understand how charges are set and enable them to access their right to early repayment without sanction. In particular, the Central Bank could issue guidelines requiring lenders to ensure consumers are provided with regular information about how early repayment charges are calculated. It is difficult to see how this could undermine the aim of the Directive of harmonising consumer protection. Indeed, such a clarification of consumer's information rights would appear to be consistent with the ethos behind the Directive of ensuring borrowers have effective consumer protections.

[73] Central Bank of Ireland, *Correspondence with Deputy Michael McGrath TD re breakage fee methodology for fixed-rate mortgages* (2018) 1-9.
[74] Central Bank of Ireland, *Correspondence with Deputy Michael McGrath TD re breakage fee methodology for fixed-rate mortgages* (2018) 1-9.

6 Reasonable Forbearance

The legal regime governing lender's powers of enforcement has been substantially reformed in Ireland in the years post the 2008 financial crisis. The extent of reform in this area reflects how in the 2008 crisis in Ireland was characterised by an extraordinary increase in mortgage default and arrears.[75] The arrears crisis reached its peak in 2013, when approximately 13% of all residential mortgage accounts were in arrears of more than ninety days.[76] While there was an associated increase in repossessions since 2008, the threat of a tsunami of evictions appears to have been averted. This can be attributed to a variety of factors but in particular to extensive state intervention involving law and policy measures including substantial reforms to the legal framework governing enforcement of the lender's powers of enforcement.[77] As part of these reforms, procedural and substantive due process controls, including debt restructuring and forbearance requirements, have been introduced governing the lender's right to possession and sale. As a consequence of these developments, Ireland's legal framework governing the lenders powers of enforcement is among the most extensive and developed in the European Union, and thus is of relevance to the ongoing review of the MCD.

6.1 Due Process Controls on the Lender's Power of Enforcement

A 'housing loan' in Irish law is a form of mortgage and as such it is governed by Irish land law. As noted earlier in section 2, Irish land law provides lenders with extensive statutory powers of enforcing the security including, in particular, the right to apply to the court for an order of possession and/or an order of sale in the event of default. Since the financial crisis, the lender's right to possess has been subject to extensive reforms which have introduced a range of procedural and substantive controls on its exercise. In particular, Land and Conveyancing Law Reform (Amendment) Act (LCLRAA) 2019 requires the court dealing with mortgage possession cases, involving the principal private residence of the borrower, to consider a set of factors including:

- whether the making of the order would be proportionate in all the circumstances;
- the circumstances of the mortgagor and his or her dependents (if any) in respect of whom the principal private residence the subject of the proceedings is their principal private residence;
- whether the mortgagee has made a statement to the mortgagor of the terms on which the mortgagee would be prepared to settle the matter in such a way that

[75] Lynch Shally (2020) 123.
[76] Central Bank of Ireland, *Mortgage Arrears and Repossessions Statistics: Q1 2016* (2015) 1.
[77] Kenna (2020) 23.

the mortgagor and his or her dependents could remain in the principal private residence;
- the details of any proposal made, whether prior to or following the commencement of the proceedings by, or on behalf of, the mortgagor to enable the mortgagor and his or her dependents to remain in the principal private residence, including any proposal for participation by the mortgagor in a designated scheme, or to secure alternative accommodation;
- the response, if any, of the mortgagee to any such proposal; and
- the conduct of the parties to the mortgage in any attempt to find a resolution to the issue of dealing with arrears of payments due on foot of the mortgage.[78]

In considering whether a repossession of a mortgaged home is proportional the Court must have regard to the amount of the principal and arrears remaining, and the market value of the home at the date the proceedings began.[79]

6.2 Obligations in the Context of Mortgage Arrears

In addition to the statutory rules governing repossession, 'housing loans' are also subject to a special regulatory regime that imposes obligations, involving due process and forbearance requirements, on lenders. In particular, the Central Bank of Ireland's Code of Conduct on Mortgage Arrears 2013 (CCMA) provides a framework that lenders must follow when dealing with borrowers in mortgage arrears or in pre-arrears. The protections provided to the borrower attach to the loan and will continue to apply where the lender sells the mortgage to a third-party lender. While these protections predate the MCD, they have been substantially reinforced by its transposition. This is because the Regulations transposing the MCD make clear that the threshold for what constitutes 'reasonable forbearance' on the part of the lender, as required by the MCD, is set out in the CCMA.

Under the CCMA, lenders are required to operate a Mortgage Arrears Resolution Process (MARP) that applies to dealing with borrowers in arrears and pre-arrears. In this process, lenders are required to handle all such cases sympathetically and positively, with the objective of assisting the borrowers to meet their mortgage obligations. Under the code, lenders are subject to a general obligation not to apply for an order for possession until 'every reasonable effort' has been made to reach an alternative repayment arrangement.[80]

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[78] The LCLRAA amends part of the Land and Conveyancing Law Reform Act 2013, which enables the Court to adjourn the hearing for up to two months to allow a party to the proceedings to put in place a personal insolvency arrangement (PIA).
[79] Kenna (2020) 31-33.
[80] CCMA 2011, Ch.3, s.46

In addition, where the borrower is in arrears but is co-operating with the lenders, the lender is restricted from applying for possession for either eight months from the time that the arrears first arose, or three months from after the borrower has been notified that they are outside the MARP, whichever is later.

This Code applies to the mortgage loan of a borrower which is secured by his/her primary residence. The term ‘primary residence’ means a property which is the residential property which the borrower occupies as his/her primary residence in the State, or a residential property which is the only residential property in the State owned by the borrower. The protections available under the MARP are also contingent on the borrower co-operating with the lender. Where the borrower is classified as ‘non’ cooperating’ then they will lose the protections of the MARP and the lender will be able to start legal proceedings immediately. The CCMA provides a detailed definition of what constitutes 'not co-operating' with the lender. A borrower will be declared 'not co-operating' when:

a) They fail to make a full and honest disclosure of information that would have a significant impact on their financial situation;
b) They fail to provide relevant information within the specified timeline;
c) A three-month period elapses during which the borrower has not entered an alternative repayment arrangement, has failed to meet repayments or clear arrears, or fails to respond to communications from the lender.

There are four components that must be present in a lender’s MARP for it to comply with the CCMA. The first component is communication, and this sets out how the lender should communicate with the borrower. This provides several general requirements including that the lender must ensure that the level of communication is proportionate and not excessive as well as more prescriptive requirements in relation to the development of lender’s communication policies and the content and form of written communications to the borrower.[81]

The second component relates to financial information. The CCMA requires lenders to use the standard financial statement to gather information from the borrower about their monthly income and outgoings. The lender must offer to assist the borrower with completing the statement, inform the borrower that they may seek independent advice and provide the borrower with a copy of the statement. The lender may require the borrower to provide supporting documentation and impose a timeline for the

[81] CCMA 2013, s. 12-29.

return of information. This timeline must be fair and reasonable and reflect the type of information requested.[82]

The third component involves the lender assessing the completed standard financial statement in a timely manner. The CCMA requires the lender to examine each case on its individual merits and base its assessment of the borrowers case in light of the full range of circumstances including personal circumstances of the borrower, overall indebtedness of the borrower, the information provided in the statement, the borrower's current repayment capacity and the borrower's previous repayment history.[83] While assessing the statement, the lender may agree to a temporary repayment arrangement with the borrower where this would avoid a delay that exacerbates the borrower's arrears or pre-arrears.

Resolution is the final component in the MARP. Under the CCMA the lender is required to explore all of the options for alternative repayment arrangements offered by that lender. These may include the following arrangements:

a) interest only repayments on the mortgage for a specified period of time;
b) permanently reducing the interest rate on the mortgage;
c) temporarily reducing the interest rate on the mortgage for a specified period of time;
d) an arrangement to pay interest and part of the normal capital amount for a specified period of time;
e) deferring payment of all or part of the scheduled mortgage repayment for a specified period of time;
f) extending the term of the mortgage;
g) changing the type of the mortgage;
h) adding arrears and interest to the principal amount due;
i) equity participation;
j) warehousing part of the mortgage (including through a split mortgage);
k) reducing the principal sum to a specified amount; and
l) any voluntary scheme to which the lender has signed up e.g. Deferred Interest Scheme.[84]

The CCMA requires that the lender documents its consideration of each option and explains the reasons why the option(s) offered to the borrower is/are appropriate and sustainable in light of the borrower's circumstances. Where an option(s) is (are) ruled out and not offered, the lender must also explain why this option(s) is not appropriate

[82] CCMA 2013, s. 30-34.
[83] CCMA 2013, s. 35.
[84] CCMA 2023, s. 42

and sustainable for the borrower's individual circumstances. There is an explicit prohibition on the lender from requiring the borrower to change from an existing tracker mortgage to another mortgage type.

Where the lender offers an alternative repayment arrangement, they must explain to the borrower how the arrangement works and advise them to obtain independent legal and financial advice. The CCMA sets out prescriptive information requirements which the lender must follow when giving the borrower this explanation. Where an alternative repayment arrangement has been put it place it must be regularly reviewed by the lender.
If the lender concludes that the mortgage is not sustainable and that an alternative repayment arrangement is unlikely to be appropriate, it must let the borrower know, explain the reasons for that conclusion, and inform the borrower of the other options available to them and their right to appeal the decision.

6.3. Assessing the Effectiveness of the Forbearance Requirements

The Central Bank of Ireland has reviewed the CCMA and indicated that it has helped to contribute to a decline in the percentage of residential mortgage accounts that were in arrears of more than ninety days, which has fallen from 13% in 2013 to 4% in 2023.[85] Although the high numbers of long-term arrears (greater than one year) has also declined during this period, one of the legacies of the crisis has been the persistence of long-term arrears –3.1% of all residential mortgage accounts were in long term arrears in 2023.[86]

In some respect the legal regime governing the lender's powers of enforcement can be regarded as representing best practice. This is particularly the case in relation to the Land and Conveyancing Law Reform (Amendment) Act 2019 which introduced procedural and substantive controls on the lenders right to repossess the dwelling. This reform was inspired by, and incorporates, international human rights norms and standards around protection of the home and the right to housing.[87] These measures have helped to counterbalance the strong property rights of the lender and they promote the important social policy of protecting the home from arbitrary

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[85] Central Bank of Ireland, *Residential Mortgage Arrears & Repossessions Statistics – Q1 2023* (2023) 4.
[86] Central Bank of Ireland, *Residential Mortgage Arrears & Repossessions Statistics – Q1 2023* (2023) 4.
[87] Kenna (2020) 32-33.

interference. Far from destabilising the market, these measures have arguably contributed to greater economic and social stability.[88]

However, there remain serious limitations with this legal regime stemming from a lack of access to justice for consumers and the lack of training and education of the judiciary which both significantly undermine the effectiveness of the regime. A 2020 study of mortgage possession cases in Ireland found that 'only one quarter of borrowers had any Listed legal representation'.[89] This reflects the limited access to free legal aid in Ireland.[90] This is a particularly significant problem in this area because of the complicated nature of mortgage possession proceedings which requires that appropriate legal representation be made available.[91]
Ultimately, the lack of access to legal advice undermines access to justice and means that the formal protections are often rendered substantively ineffective in practice.[92] At the same time, Kenna has pointed out that judicial training around the forbearance framework is 'urgently required for lawyers and judges to ensure that citizens are in a position to enjoy their legal rights in Ireland'.[93] When reviewing the MCD, it is vitally important that strengthening access to justice for borrowers is recognised as a prerequisite of EU consumer and human rights law, including the Charter of Fundamental Rights.

7 The Lack of Effective Legal Remedies for Consumers

Over the last decade, the regulatory framework governing residential mortgage lending has been substantially reformed and various changes have been made to the enforcement framework. However, various banking scandals show that old habits die hard. For instance, in the 'tracker scandal' tens of thousands of consumers were denied access to a cheaper tracker rate and as a result they were overcharged by their lender while dozens of affected households lost their home.[94] Further gaps in the consumer protection framework have been exposed by the 'mortgage prisoners' scandal.[95]

In different ways the tracker scandal and mortgage prisoners' scandals demonstrate the lack of effective legal remedies for consumers dealing with lenders engaging in

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[88] Central Bank of Ireland, *Report on the Effectiveness of the Code of Conduct on Mortgage Arrears in the context of the Sale of Loans by Regulated Lenders* (2018) 9.
[89] Kenna (2020) 9.
[90] Kenna (2020) 11.
[91] Kenna (2020) 21-22.
[92] Kenna (2020) 21-22.
[93] Kenna (2020) 21.
[94] Kenna (2020) 24.
[95] See https://www.independent.ie/business/personal-finance/central-bank-fast-asleep-over-plight-of-mortgage-prisoners/a703412853.html

unfair and/or irresponsible lending practices. The Central Bank of Ireland is responsible for enforcement of the regulations governing residential mortgage lending. In that capacity it sets standards by issuing codes that govern conduct of business rules and has wide powers of imposing fines and instigating prosecutions.[96] In addition, the Central Bank has a power to order redress where consumers have suffered, are suffering or will suffer loss or damage.[97] However, as Lynch-Shally notes, this remedy is decidedly limited in practice because the threshold to trigger redress is 'macro focused' and at the discretion of the Central Bank and thus the main enforcement actions involve fines and prosecutions.[98]

While these main enforcement mechanisms have an important role to play, they are of little legal value to an individual consumer dealing with a lender engaging in unfair and/or irresponsible lending practices. The Irish Courts have made clear that the Codes issued by the Central Bank do not constitute legislation and thus do not alter the private law rights of the lender and the borrower under the mortgage contract, unless they have been integrated into primary or secondary legislation.[99] While Irish law provides consumers with a statutory right of action for damages for a breach of 'financial services legislation', the Codes issued by the Central Bank do not constitute 'financial services legislation' and so this right has proved to be of symbolic, rather than practical value, to consumers.[100]

Finally, consumers have a right to challenge, and have set aside, unfair contractual terms under the Unfair Contract Terms Directives.[101] The ECJ has recognised that these protections apply to residential mortgages involving consumer contracts.[102] In particular, the ECJ has determined that a national court is required to examine of its own motion the compliance with the rules of EU consumer protection law including residential mortgages.[103] However, in practice, this protection has been undermined through a 'reluctance by courts and the relevant regulatory State bodies to subject standardised non-negotiable mortgage contracts to scrutiny'.[104]

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[96] Lynch Shally (2020) 130.
[97] Central Bank (Supervision and Enforcement) Act 2013, s. 43.
[98] Lynch Shally (2020) 130.
[99] *Irish Life & Permanent Plc v Dunne and Dunphy* [2015] IESC 46 SC, 17. The Regulations transposing the MCD have integrated the threshold for reasonable forbearance set out in the CCMA 2013 but there has been no similar integration of the CPC 2012 – the main code governing conduct of business rules.
[100] See Lynch Shally (2020) 146-147.
[101] European Communities (Unfair Terms in Consumer Contracts) Regulations 1995, SI 1995/27. These Regulations were amended on a number of occasions.
[102] ECJ 14 March 2013, *Mohamed Aziz v Caixa d'Estalvis de Catalunya*, Case C-415/11, EU:C:2013:164, para. 68.
[103] Kenna & Sadlier (2019) 126.
[104] Kenna & Sadlier (2019) 124.

In summary, the lack of effective legal remedies for consumers has become a recurring theme within Irish mortgage law. Even where statutory rights of action have been introduced, these have proved to be of symbolic, rather than practical value, to consumers. Furthermore, where consumer protections have been extended as a result of decisions of the European Court of Justice, these developments have been met with judicial and regulatory reluctance to give effect to those decisions in national law.

V Conclusion

Over the past decade, the dynamics of this crisis have shifted from one involving mortgage arrears to one involving deepening unaffordability of both home ownership and private renting. In many ways, this reflects how the 2008 financial crisis, and the subsequent reforms, did not lead to a transformation of the pre-crisis housing model, which remains centred around the state promotion of highly marketised and financialised forms of ownership and renting. At the same time, there have been various significant developments in the Irish mortgage market during the last decade.

Some of the developments in the mortgage market have revealed gaps in the regulatory and consumer protection framework and suggest a role for the recast MCD. There has been a remarkable increase in the role of non-bank lenders, which has been largely driven by the transfer of loan portfolios by retail banks to, so called, vulture funds. This was encouraged by the Irish Government and the European Central Bank (ECB) as a means of reducing the numbers of non-performing loans held by Irish lenders. Despite assurances, many consumers have become 'mortgage prisoners' locked into paying a much higher mortgage rate which raises the risk of arrears and default. The recent Directive on credit servicers and credit purchasers does little to address the problems facing current 'mortgage prisoners' and more action is needed, nationally and at EU level, to ensure that consumers are not prejudiced by the transfer of their loans to 'vulture funds'.

Another striking development is the growing prominence of 'green mortgages', which now account for about a third of all residential mortgage lending in Ireland. While they are presented as a means of achieving Ireland's decarbonisation goals, they have been criticised as a form of greenwashing. This is because, as presently designed, green mortgages do not involve a loan that is backed by environmental initiatives or carbon offsetting schemes. They have also been criticised for exacerbating existing housing inequalities. This is because such loans are targeted at more expensive new build housing and, in practice, are more prevalent in higher income groups. Given the urgency of the climate crisis, there is a pressing need for national and EU regulatory agencies to ensure such lending is genuinely environmentally impactful and more widely available.

The changes in the Irish mortgage market and, in particular, the 'mortgage prisoners' scandal, reveal how the lack of effective remedies for consumers continues to be a recurring theme in Irish mortgage law. Where the Central Bank identifies that a lender is in breach of its conduct of business rules, it tends to impose fines as the primary means of enforcement and there is little recognition of the individual consumer as a rights holder who should have access to effective legal remedies. Indeed, the regulatory framework provides consumers with precious few effective rights and arguably enables the Central Bank to adopt an overly cautious and reactive, rather than proactive, regulatory approach. This is particularly apparent in relation to early repayment charges. Despite indications of deviations in the calculations of compensation undertaken by various lenders, the Central Bank has decided against proactively developing guidance on how lenders should interpret the term 'financial loss'. Instead, it has sidestepped the issue by deferring to the European Banking Authority on the matter.

While the recast MCD could help to close various gaps in the Irish consumer protection framework, there are aspects of Irish mortgage law that may be regarded as representing best practice internationally and which could serve as a basis for informing the development of the recast MCD. This is particularly the case in relation to the procedural and substantive due process controls, including debt restructuring and forbearance requirements, which have been introduced since 2008. These measures incorporate international human rights norms and standards around protection of the home and the right to housing. By facilitating debt restructuring arrangements, they have contributed to a decline in the percentage of residential mortgage accounts in arrears. These measures counterbalance the strong property rights of the lender and promote the important social policy of protecting the home from arbitrary interference. They also indirectly encourage more responsible lending decisions thereby contributing to greater economic and social stability. However, in practice, the effectiveness of such protections is limited by the lack of access to legal advice, and it would be a welcome development if the recast MCD emphasized the rights of consumers to independent legal advice.

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CHAPTER 7

SOME PROBLEMATIC ISSUES CONCERNING THE IMPLEMENTATION OF THE MCD IN ITALY

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I Introduction

The Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property (MCD) was transposed in Italy by the Decreto legislativo (legislative decree) of 21 April 2016, no. 72. The implementing regulation of domestic law was included in the general regulatory framework of banking and financial services set by the Decreto legislativo of 1 September 1993, no. 385 ('Testo Unico Bancario', TUB, Chapter I-*bis*, Title VI). Eight years have elapsed since the implementation of the MCD in Italy, and one may well argue that the European regulation has certainly marked the strengthening of a classical perspective linking property (i.e. ownership of residential property) to credit (i.e. loan contracts); however, such dyad was put into a regulatory dimension entwined with consumer law and this intersection had a significant impact on the evolution in the understanding of property rights when combined with credit contracts concluded by parties who are not on the same footing.

It has often been pointed out that the MCD was aimed at fostering two regulatory objectives relating to this realm of law, namely, (i) the well-functioning of the market and (ii) to combat risks of consumer over-indebtedness.[1] However, the triggering point stimulating the adoption of the MCD has been symbolised by a growing awareness of the existence of divergent legal approaches among Member States in considering the conduct of business when granting credit agreements that specifically relate to residential immovable property as well as in the regulation and supervision of credit intermediaries and non-credit institutions which provide credit agreements

[1] On the objective underlying the MCD, see Sirena & Farace (2021) 269. The twofold protective nature that characterizes the MCD proves in line with the rationale underlying the rules established in the United States by means of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301, §§ 5481-5603, and in laws amended at Title X. An analysis of the American regulatory intervention is provided by Jackson (2011) 189.

for these purposes.[2] As widely known, it was a response to the crisis caused by subprime mortgages in the United States.[3]

The MCD rests mainly on two tools for pursuing the goal of responsible lending, and they are fully embraced by the Italian legislature: (i) a precontractual creditworthiness assessment of the consumer (Arts 18 and 20 MCD; Art. 120-*undecies* TUB); (ii) an appropriate evaluation of residential immovable property for the purpose of granting mortgage-backed credit (Art. 19 MCD; Art. 120-*duodecies* TUB).[4]

Interestingly, this Directive deals with the governance of the credit process, in which the MCD rules are designed to conform and discipline parties' initiatives, with the end of forging effective tools for offering services on the market.[5] In this respect, the decision of the European legislature to specifically regulate this area was triggered by an acknowledged lack of relevant norms at supranational level.[6] Hence, the adoption of the MCD hinged on the assumption that the irresponsible behaviour of lenders was determined by the absence of a regulation of this sector and not by the violations of rules of conduct by lenders themselves.[7] From a more general perspective, this could also be deemed an oddity if one considers the deep connection between consumer credit and fundamental rights.[8]

Compared to the time when the MCD was implemented, the current Italian scenario, as is the case elsewhere, appears to be influenced by the well-known emergence of new technologies, artificial intelligence (AI) and digitalisation, which can play a pivotal role on how European standards, as duly transposed in Italy, are to be interpreted and should work. By way of example, in continuity with an ongoing debate in several EU Member States, scholars and institutions are paying growing attention to the intersection between artificial intelligence and credit scoring, as testified by a number of studies published on this topic;[9] and it is worth stressing how,

[2] See Recital 2 of the MCD. The historical root of the MCD can be traced back to the White Paper of 18 December 2007 on the Integration of EU Mortgage Credit Markets presented by the Commission COM (2007) 807 final, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:l24487

[3] On this point, see recently Sirena (2024a) 130.

[4] Sirena (2024a) 130-131.

[5] See Valzer (2021) 896.

[6] Recital 4 of the MCD.

[7] See Valzer (2021) 898.

[8] See Cherednychenko (2017) 139; Ferretti & Vandone (2019) 156.

[9] See Bonaccorsi di Patti, Calabresi, De Varti & others (2022).

even beyond creditworthiness, Italian courts started to be confronted with problems posed by the interplay of algorithms and reputational rating.[10] As mentioned, this reflects a tendency that can already be observed in Europe, where studies on how machine learning are used in the context of Internal Ratings-Based (IRB) models are increasing significantly.[11] And also the interest showed by the EBA is illustrative in this regard.[12]

Notwithstanding the incidence of AI and new technologies on the credit sector, the main problematical issues addressed at domestic level by Italian courts and scholars remain anchored to the traditional skeleton of the MCD and its junction with the Directive 2008/48/EC on consumer credit agreements (CCD 2008)[13] which was transposed in Italy, becoming part of the TUB (Arts 121 ff.), and that will soon be completely repealed with the implementation of the Directive 2023/2225/EU (CCD 2023).[14]

Accordingly, in the light of the domestic background that has just been depicted, this chapter is structured as follows: sections II and III, respectively, illustrate the relevant issues related to the national implementation of the MCD's rules on pre-contractual duties of information and effective creditworthiness assessment; section IV analyses foreign currency loans; and section V is dedicated to the topic of consumers' rights in case of early repayment, which has undoubtedly been one of the issues that has attracted the most attention in case law and academic writing over the past five years.

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[10] See *Corte di cassazione*, 10 October 2023, no. 28358, examined by Falletti (2024) 245 and Brutti (2024) 402.

[11] See Aggarwal (2019) 37-45; Langenbucher (2020) 527; Ammannati & Greco (2021) 305; GoetghebuerC (2021) 429; Langenbucher & Corcoran (2022) 141; Montagnani & Paulesu (2022) 557; Spindler (2023) 239; Rabitti (2023) 175.

[12] EBA, Machine Learning for IRB Models. Follow-up Report from the Consultation on the Discussion Paper on Machine Learning for IRB Models (2023), https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2023/1061483/Follow-up%20report%20on%20machine%20learning%20for%20IRB%20models.pdf

[13] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJ L 133/66 of 25 May 2008).

[14] Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC (OJ L 2023/1 of 30 October 2023). The deadline for the transposition of the CCD 2023 is 20 November 2025.

II Pre-Contractual Information

Pre-contractual information, addressed by Chapter IV of the MCD, has been transposed by the Italian legislator within Chapter I-*bis* of the TUB and, specifically, in Articles 120-*novies* and 120-*decies*.

The regulation of the pre-contractual phase, with the aim of enabling the appropriate formation of the consumer's will, was already provided for in the CCD 2008. The reason for this is that the underlying purpose of European interventions is to create and preserve a transparent, competitive and ultimately efficient credit market. However, whilst the intervention of 2008 had opted for a high level of harmonisation, in the MCD the EU legislator considered the peculiarities of national laws, providing for full harmonisation only for the regulation of personalized pre-contractual information and the Annual Percentage Rate of Charge (APRC).[15]

It should also be noted that credit agreements for consumers relating to residential immovables are often complex for the average consumer to understand. Hence, pre-contractual information plays a crucial role, in the sense that it is the means through which the consumer can come to a comprehension of the rights and obligations arising from the contract.

Moreover, pre-contractual information relates to the creditworthiness assessment in a double perspective. First it is the creditor who must provide the preparatory information on the contract that will be offered, while at a later stage it is up to the consumer to provide the information necessary to enable the counterparty to make the creditworthiness assessment.[16]

With regard to the information that the lender is required to outline, Italian law follows the distinction between standard and personalized information.[17]

Standard information, described in para. 1 of Article 120-*novies* TUB, shall be made available to the consumer at any time, so that the latter can understand and compare offers. In particular, the lender is required to make available to the consumer a document containing clear and understandable information, on paper or on another durable medium, that indicates the requirements to be provided by the consumer for the purpose of creditworthiness assessment, a warning that credit may not be granted if the consumer fails to submit the documents necessary to verify creditworthiness, the consultation of a database and the possibility of receiving advisory services. Article

[15] Pischedda (2018) 2000; for a history of EU regulation on the topic of consumer credit, see Howells, Twigg-Flesner & Wilhelmsson (2018) 217-219.

[16] Semeraro (2021) 687; Addante (2022) 925.

[17] Pagliantini (2014) 523.

120-*novies* TUB then refers to regulatory legislation for further details related to standard information. In particular, reference should be made to the Bank of Italy Order of 30 September 2016 (Chapter VI-*bis* of this Order, para. 5.2.1).[18]

Personalised information is instead addressed by the second paragraph of Article 120-*novies* TUB. This information fulfils its function in a phase subsequent to the one covered by standard information, and implies an active behaviour of consumers, who, on the ground of the first information received, can give details to the lender on their specific needs or preferences, as well as their financial situation, in order to obtain a retail offer.[19]

In view of the aim of enabling a pondered and informed decision by the consumer, personalized information must also be provided on paper or on another durable medium, through the delivery of the form known as the 'European Standardised Information Sheet' (ESIS). ESIS must be drawn up as described in Annex 4E to the aforementioned Bank of Italy Order of 30 September 2016, where a sample of ESIS is given.[20]

The Italian rules also provide that before the conclusion of the credit agreement, the consumer is entitled to a reflection period of at least seven days to compare the different credit offers on the market, assess their implications and take an informed decision. During this reflection period, the offer is binding on the lender and the consumer may accept it at any time.[21]

Further rules on pre-contractual information are set out in Article 120-*decies* TUB, which, with respect to credit intermediaries, not only includes provisions similar to those in Article 120-*novies* TUB, but also lays down some more specific indications. The reference is, *inter alia*, to the obligation to clarify whether the credit intermediary is subject to a mandate or works exclusively with one or more lenders, the fee to be paid by the consumer to the intermediary and the procedures through which consumers or other interested parties may lodge complaints against the intermediary.[22] The aim is therefore to ensure the transparency of the transaction

[18] Bank of Italy, 'Trasparenza delle operazioni e dei servizi bancari e finanziari. Correttezza delle relazioni tra intermediari e clienti'. Available at: www.bancaditalia.it/compiti/vigilanza/normativa/archivio-norme/disposizioni/trasparenza_operazioni/testo-disposizione-2019/Disposizioni_Testo_integrale.pdf

[19] See again Pischedda (2018) 2006.

[20] Maffeis (2016) 188; Las Casas (2015) 251.

[21] Art. 120-*novies* TUB, para. 3.

[22] The Italian Organismo per la gestione degli Elenchi degli Agenti in attività finanziaria e dei Mediatori creditizi, in its Communication no. 14/17, with reference to Art. 120-*decies* TUB, clarifies that the intermediary, before the signing of the contract, is obliged to provide the consumer (for comparative

from a subjective point of view, i.e. regarding the identification of the counterparty in the negotiation.[23]

None of the aforementioned provisions of the TUB specify the legal consequences triggered by non-compliance with information obligations by the lender. This legislative option has given rise to an intense debate on the remedies available to the consumer, exacerbated by the fact that while European law assumes that this party is in a physiological position of asymmetry compared to the contractual counterparty, the rules of the Italian Civil Code mainly relegate this case to a pathological phase, on the implicit assumption that private parties negotiate on an equal playing field.[24]

In abstract terms, two areas of general contract law are called into question by a violation of information duties: rules on pre-contractual liability, protecting the party's freedom of contract in case of a breach of good faith and fair dealing in negotiations (Arts 1337, 1338 Italian CC), and rules on defects of consent (relevant, in particular, in the form of mistake and fraud).[25] While the latter remedies are explicitly presented as a ground of contractual invalidity (Art. 1427 Italian CC), the former norms impose of duty of conduct whose infringement has been traditionally sanctioned with a claim for pecuniary damages granted to the non-breaching party.[26]

This outcome reflects the consolidated view that Italian law affirms a rigid separation (so called 'non-interference') between 'rules of validity' (*regole di validità*), which pertain to the structure and content of the contractual agreement, and whose violation leads to nullity or voidability of contract, and 'rules of behaviour' (*regole di comportamento*), for which a general compensatory liability is provided, and that cannot lead to the invalidity of the contract except when expressly provided for by law.[27] This distinction is firmly rooted in the Italian legal tradition, which ultimately dictates that rules of validity cannot be derived by the interpreter by a concretisation of the general clause of conduct, such as that of good faith.[28]

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purposes) with information as close as possible to reality, especially on the amount of the commissions relating to each lender's range of products.

[23] See Cordeddu (2018) 2012.

[24] On the information obligations in Italian and European contract law, see, *ex multis*, Grundmann (2001) 257; Roppo (2004) 747; Grisi (2011) 595; Alessi (2013) 311. For a wider overview on the obsolescence of the Italian Civil Code rules on these contractual aspects, see Zoppini (2021) 313.

[25] Italian literature is particularly broad on this topic. See, for classic references, Stolfi (1954) 1108; more recently Orlandi (2021) 996.

[26] D'Amico (1996); Vettori (2003) 249; Scoditti (2006) 1105; Scognamiglio (2008) 619.

[27] The leading cases are *Corte di cassazione*, Sezioni Unite, 19 december 2007, no. 26724 and no. 26725; for comments, see Gentili (2008) 221; Salanitro (2008) 445.

According to this principle, still adhered to by the majority, it is excluded that the breach of pre-contractual information obligations by the lender may affect the validity of the contract, allowing the consumer to obtain (only) compensation for damages resulting from the erroneous, incomplete, or false information rendered in the negotiation stage.[29]

At the same time, it must be stressed that according to several commentators and doctrinal orientations, the distinction between *regole di comportamento* and *regole di validità,* as rigidly enforced by Italian case law, is to be considered outdated, especially in the light of European-derived law, which, with a view to rebalancing the relationship between parties with different contractual power and levels of information, often provides for behavioural rules which are eventually associated with provisions of invalidity, as in the case of information obligations associated to the formalities imposed in the formation of consumer contracts.[30]

This observation, according to different scholars, calls into question the exceptional nature of the validity rules, and opens to a possible valorisation of the general clause of good faith[31], which could give legal relevance to certain conducts that, although not directly laid down in the contract, shall be considered binding and capable of rendering the unfair contract invalid.[32]

III Creditworthiness Assessment

The creditworthiness assessment is crucial to ensure compliance with the responsible lending parameter, which represents a seminal point of intersection between private law and market regulation.[33]

It is not happenstance that the lender's duty to carry out a creditworthiness assessment is regarded as a tenet of this area of law, which revolves around the need to forge more responsible markets and to avoid endemic risks of over-indebtedness of

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[28] For a recent analysis of the non-interference principle in Italian case law, see Grimolizzi (2023) 1946-1956.

[29] See *Corte di cassazione*, 8 October 2008, no. 24795 (2009) I *Foro italiano* 440; *Corte di cassazione*, 17 September 2013, no. 21255 (2013) *Europa e diritto privato* 1097.

[30] Galgano (1997) 418; Perlingieri (2013); Cicero (2014) 539.

[31] See Roppo (2020) 83.

[32] Riccio (1999) 21.

[33] This topic came progressively to be ascribed to private law, despite being originally understood as a duty rooted in administrative law: see Badenhoop (2020) 233-266.

European consumers. This is the reason why the creditworthiness assessment of any borrower is carried out by financial intermediaries, banks and creditors, who are therefore responsible for consumer lending.[34] The notion of responsible lending is rooted in the CCD 2008, and has been transposed in Italy, as part of the TUB (Arts 121 ff.). Its Art. 124-*bis*, which mirrors Art. 8 of the CCD 2008, expressly states that, prior to the conclusion of the credit agreement, the lender shall assess the consumer's creditworthiness on the basis of adequate information; relevant data can be provided by the consumer and may be accessed by consulting public or private databases or a credit reporting agency (CRA),[35] which, in the Italian context, can be either private or public.[36] Private CRAs are underregulated in Italy (and in Europe), since they are commonly understood to be little more than vessels storing customer data that has been furnished by specific suppliers, such as banks, intermediaries and also consumers. Generally CRAs are deemed to play a 'neutral' role in the credit market, and the domestic approach tends to exempt them from liability in case of data errors impacting on the financing.[37] Yet, the typical features of CRAs show how they are provided with a quasi-regulatory function, [38] being essential both for the well-functioning of the market and for the parties to a credit agreement.[39] The urgency to reflect upon their actual role in the market is crucial for effectively reaching those objectives connected to the creditworthiness assessment that are carefully taken into consideration by the European legislature.

[34] Recently, Vardi (2022).

[35] On a possible typological distinction between credit bureaus and private credit reporting agencies see Sciarrone Alibrandi (2005), 4 fn. 8; from a different perspective, Ferretti (2013) 798.

[36] On the difference between the activities of public and private reporting agencies, see Dolmetta (2004) 533). From a more general perspective, the two categories of credit bureaus represent a distinctive element characterising the Italian legal background, since a comparative analysis shows that public and private rating agencies do not always coexist in other Member States. The credit bureau set up at the Bank of Italy ('Centrale Rischi') is a national credit agency, which is regulated through primary sources: see Sciarrone Alibrandi (2003) 423.

[37] Tribunale Salerno, 22 April 2002 (2003) II *Giurisprudenza commerciale* 210. Historically, this tendency appears similar to that which occurred outside Europe. Taking a cue from the US legal background, see McNamara Jr. (1973) 71: 'during the period of their phenomenal growth, credit bureaus have somehow escaped the focus of both state and federal inquiry and regulation in spite of the existence of serious abuses'.

[38] On this topic, see Mezzanotte (2017) 303; Buonanno (2022) 582.

[39] It is worth emphasising that, even though financial intermediaries or banks may be regarded as parties highly interested in the data accuracy, owing to which they can make correct credit-based decisions, it is quite apparent how the direct beneficiaries of that accuracy coincide with the customers (i.e. consumers and businesses, whose credit data are processed). On this aspect, see Krist (2015) 2314.

Beyond this aspect, it has been pointed out already that the need to further strengthen the duty of creditworthiness assessment was pursued by the MCD. In addition to its above-mentioned objectives, the TUB embraces all the tools for reaching the regulatory aims of the MCD.[40]

Furthermore, pursuant to Art. 120-*undecies* TUB, the creditworthiness assessment is made on (necessary, sufficient and proportionate) information regarding the consumer; however, this article should not be understood as meaning that information is *primarily* collected and obtained by the consumer, since it may well be furnished by other sources. This interpretation is grounded on Art. 20 MCD, which clarifies how creditors should base their assessment on internal and external sources, including the consumer.[41] The lender shall not terminate the credit agreement concluded with the consumer or make any changes thereto that are unfavourable to the consumer on the grounds that the creditworthiness assessment was carried out incorrectly or that the information furnished by the consumer prior to the conclusion of the credit agreement proved incomplete; however, the possibility to terminate the contract comes into play if the consumer is involved in the conveying data process and has intentionally withheld such information or has supplied false information (Art. 20 MCD; Art. 120-*undecies* TUB).

As to the advisory service that is required in this ambit, the intermediary is not obliged to guarantee assistance to the consumer as to the most convenient credit contract that, based on the latter's interest, could be concluded (Art. 22 MCD).[42] Moreover, this contract can also be stipulated relying solely on the information obtained by consumer, on the proviso that it is sufficient;[43] in this respect, there is no obligation on the intermediary to provide an advisory service to the consumer nor to carry out systematic checks pertaining to veracity of the information given by the consumer.[44]

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[40] It is the case of the pre-contractual creditworthiness assessment of the consumer (Arts 18 and 20 MCD, which are implemented by Art. 120-*undecies* TUB); moreover, there is the need to make an evaluation of residential immovable property for the purpose of granting mortgage-backed credit (Art. 19 MCD; Art. 120-*duodecies* TUB). See above, I.

[41] See also Recital 58 MCD.

[42] See Petrosino (2021) 417; Pagliantini (2014) 532.

[43] See ECJ 18 December 2014, *CA Consumer Finance SA v. Ingrid Bakkaus, Charline Bonato and Florian Bonato*, Case C-449/13, EU:C:2014:2464, para. 45: '[t]he creditor is in a position to give the consumer explanations based solely on information which the consumer supplies to him, so that the consumer may make a decision with regard to a type of loan agreement, without the creditor being required to assess the consumer's creditworthiness beforehand. However, the creditor must take account of the assessment of the consumer's creditworthiness in so far as that assessment means that the explanations provided need to be adapted'.

Yet, one may doubt the full validity of the latter assumption since the intermediary is often involved in the process of data transmission; even when the information is given to the intermediary by the consumer, the law currently in force does not exempt the former from monitoring the formal and substantive aspects of data itself. As already emphasised, this does not mean that the intermediary must advice clients as to the contract that best suits their interests,[45] nor is a credit institution under a duty to refrain from entering into a credit agreement which is inappropriate in light of the consumer's interests.[46] Significantly, this has also been the view taken by the Italian Banking and Financial Ombudsman ('Arbitro Bancario e Finanziario', ABF) in this regard.[47] Nonetheless, the ECJ has now overturned these deeply ingrained principles when it considers that the creditor has to refrain from concluding a contract if the creditworthiness assessment is negative, and this conclusion is based on a certain interpretation of the (not any more in force) CCD 2008, which, unlike the MCD, did not expressly recognize this duty (see now Art. 18 CCD 2023).[48]

Also, in the light of the very nature of this duty, one of the most problematical issues that had to be addressed at national level pertains to the consequences stemming from the infringement of that obligation. EU law does not govern the relevant penalties, the identification of which is normally left to Member States (Art. 23 CCD 2008).[49] In the Italian context, the widespread approach traditionally hinged on the idea that, once the disproportion between the principal disbursed by the creditor and the consumer's financial situation is ascertained (based on Art. 124-*bis* TUB), this

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[44] This is the principle elaborated by the ECJ in the ECJ 18 December 2014, *CA Consumer Finance SA v. Ingrid Bakkaus, Charline Bonato and Florian Bonato*, Case C-449/13, EU:C:2014:2464, para. 50(2), analysed by Francisetti Brolin (2015) 357.

[45] On the way by which the creditor may give certain assistance to the consumer, see Tribunale Napoli, 27 October 2020 (2020) II *Diritto fallimentare* 237.

[46] See for references Sirena (2024a) 132.

[47] See ABF Milano 3 November 2016, no. 9786.

[48] ECJ 6 June 2019, *Michel Schyns v. Belfius Banque SA,* Case C-58/18, EU:C:2019:467, paras. 49 and 50(2): 'Article 5(6) and Article 8(1) of Directive 2008/48 must be interpreted as not precluding a national rule, such as that at issue in the main proceedings, which obliges the creditor to refrain from concluding the credit agreement if he cannot reasonably take the view, following the check of the consumer's creditworthiness, that the consumer will be able to fulfil the obligations arising from the proposed agreement'.

[49] ECJ 10 October 2014, *Monika Kušionová v SMART Capital,* Case C-34/13, EU:C:2014:2189, para. 59; ECJ 16 November 2021, *Ultimo Portfolio Investment (Luxembourg) SA v. KM*, Case C-303/20, EU:C:2021:479, para. 30; ECJ 11 January 2024, *Nárokuj v. EC Financial Services,* C-755/22, EU:C:2024:10, para. 40: 'as regards the system of penalties applicable in the event of infringement of the national provisions adopted pursuant to Article 8 of Directive 2008/48, it is important to remember that, in accordance with Article 23 of that directive, that system must be defined in such a way as to ensure that the penalties are effective, proportionate and dissuasive'.

violation can justify the decision to award damages to the client, who must therefore be compensated since the pre-contractual obligation to protect debtor's interest has not been complied with. It is a rule of conduct that is tied to the good faith principle; as such, if a gross violation of that rule occurs, this may give rise to an award of damages. In this case the consumer must provide evidence of the breach of the good faith duty and the causal link between the allegedly irresponsible lending and the damage suffered.[50] This was the traditional position of the ABF and some domestic courts: the characterisation of that duty as a rule of conduct cannot lead to the contract being declared null and void.[51]

However, in the light of the recent ECJ judgments stressing how the creditor is obliged not to enter into the contract when the creditworthiness assessment is negative,[52] this must be understood as a mandatory rule. Consistently, the respect of that duty can be examined by national courts of their own motion.[53] The ECJ had already emphasized that if the credit agreement is concluded without observing the obligation to make such an assessment, the sanction of forfeiture of the creditor's right to the agreed interest proves fully appropriate.[54] The way to nullity of the contract was expressly paved in the *Nàrokuj* case decided by the ECJ: if the obligation to assess the consumer's creditworthiness is not duly fulfilled, the creditor can be penalised, in accordance with national law; in this respect the sanction may be based on the nullity of the consumer credit agreement and forfeiture of agreed interest, even though that contract has been fully performed by the parties and the consumer has not suffered any harmful consequences as a result of the breach of that obligation.[55]

Its violation represents the most appropriate ground for the recognition by Italian courts of the nullity of the contracts, pursuant to Art. 1418(1) cod. civ. In Italy, this type of nullity is commonly referred to as '*nullità virtuale*', being inferred from an assessment based on any possible violation of mandatory rules in force in the national legal system.

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[50] See ABF Napoli, 16 January 2018, no. 1067.

[51] See ABF Napoli, 18 May 2020, no. 9178; ABF Roma, 20 August 2013, no. 4440.

[52] ECJ 6 June 2019, *Michel Schyns v. Belfius Banque SA,* Case C-58/18, EU:C:2019:467, para. 49.

[53] ECJ 5 March 2020, *OPR-Finance v. GK,* C-679/18, EU:C:2020:167, para 34.

[54] ECJ 5 March 2020, *OPR-Finance v. GK,* C-679/18, EU:C:2020:167, para. 30.

[55] ECJ 11 January 2024, *Nárokuj v. EC Financial Services,* C-755/22, EU:C:2024:10, para. 52.

IV The Unfairness of the Indexation Clause in Foreign Currency Mortgage Loans

A further relevant intersection between the rules of the MCD and general principles of Italian private law is to be identified in the issues raised by the unwinding of mortgage loans indexed to a foreign currency.[56] It is widely known how the triggering point underlying the legal issue at stake has been represented by changes of the exchange rate between the national currency and foreign currency over time to the detriment of borrowers.[57]

From a legal point of view, in the light of the circumstance that loan agreements are grounded on the bank's general terms, the Directive 93/13/EEC on unfair terms in consumer contracts comes into play. Given that clauses dealing with the exchange rate risk generally constitute the main subject matter of these loan contracts, if the indexation clause is unfair, the entire contract may turn out to be null and void.[58]

This outcome paves the way to the issue of restitutionary claims relevant between parties. In Italy, the discussion on this point has been recently inspired by the need to protect weak parties, thereby expanding the traditional safeguard aims of strengthening the consumers' position before the contract is concluded and during its execution.[59] In case of investment contracts that are null and void, the rationale behind this invalidity has a crucial impact on the discipline of restitutionary effects which arise from the judicial declaration of nullity: the weak party can claim that undue payment be returned, whereas the business is not entitled to do so. Although in a different sector, this very principle, referred to as 'protective *condictio indebiti*',

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[56] In case of loans indexed to a foreign currency, the principal is expressed (and disbursed) in national currency, but the borrower's debt is nonetheless calculated by the lending bank in a foreign currency; in doing so, the lending bank applies the rate at which, according to its own rate table, it buys the foreign currency on that date. On these points, see Sirena (2024 b); Pistelli (2023) 36-37; Id. (2022a) 250-252.

[57] Practice shows that when interest rates are high in a national currency, banks are inclined to offer loans pegged to a stable foreign currency, under the obligation to comply with legal and regulatory requirements. On the relevant legal implications, see Vassileva (2020) 173-200.

[58] This is what the ECJ recently stated in *Dziubak v. Raiffeisen Bank,* Case C-260/18, EU:C:2019:819, that has been examined by Wieworówska (2020) 206, and Esposito (2020) 538. On the power of national courts when assessing the unfairness of a clause relating to the main subject matter of a financing contract, see ECJ 31 March 2023, *Lombard Pénzügyi és Lízing Zrt. v. PN,* Case C-472/20, EU:C:2022:242.

[59] See Pagliantini (2023a) 11; Id. (2019) 123; Dolmetta (2020) 89; D'Amico (2020) 7; Imbruglia (2020) 1533. The same problems have recently been addressed from a comparative law point of view: see, e.g. Mc Camus & Delfini (2023) 20.

has been already adopted by the Italian Supreme Court,[60] so that Italian scholars have proposed to extend its application to the case of mortgage loans declared invalid because of unfair indexation clauses.[61]

In the light of what has been pointed out, one may wonder whether the borrower is bound (i) to return the loan principal and, in addition, (ii) to make an allowance for the usage of it, as well as (iii) to remunerate potential recurring and up-front services carried out by the lender; likewise, it is dubious that the lender must (i) give back the instalments that have been collected but also (ii) make an allowance for the usage thereof, (iii) besides reimbursing any expenses incurred by the borrower.[62]

These doubts had found a controversial clarification in the Bank Millenium judgment rendered by the ECJ: the lending bank is obliged to return to the borrower the total amount of the monthly instalments and all expenses (regarding the performance of the agreement) incurred by the borrower, plus default interest at the statutory rate from the day on which repayment is demanded; conversely, the consumer should return to the lending bank only the principal, without being obliged to pay any interest either for the use of that principal or for arrears.[63]

This solution appears in contrast with the tenets of the traditional law of obligations,[64] whose principles should dictate that the performance unduly received by the borrower consists in a financial service encompassing the enjoyment of the value of that sum of money over time, and precisely for the whole duration of the financing. On this ground, the ECJ decision can be better framed within a regulatory perspective, where the prevalence of instances of consumer protection over the stability of financial markets may well justify that asymmetrical law of restitution envisaged by the Italian scholarship.[65]

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[60] See *Corte di cassazione*, *Sezione Uniti*, 4 November 2019, no. 28314.

[61] See recently Corletto (2024) 155.

[62] Sirena (2024b).

[63] Bank Millenium also claimed that the stability of the financial markets would be threatened if banks were not allowed to seek compensation from consumers. However, the ECJ replied that this argument proves not relevant in the context of the interpretation of Directive 93/13/EEC, on unfair terms which is aimed at protecting consumers. Additionally, 'it cannot be accepted that sellers or suppliers may circumvent the objectives pursued by Directive 93/13 on the ground of preserving the stability of the financial markets', since '[b]anking institutions are under a duty to organise their activities in in a manner which complies with that directive"'(ECJ 15 June 2023, *Szcześniak v. Bank Millenium*, C-520/21, EU:C:2023:478, paras 82-83).

[64] Sirena (2024b).

[65] See Sirena (2024b).

From a more general point of view, the incidence of the MCD proved largely ineffective in addressing these legal problems. It was deemed to be tardive compared to the time these contracts have historically been concluded in several Member States since, even though consumers hold a right to convert the credit agreement into an alternative currency –typically, the home currency– under specified conditions (Art. 23(1), MCD; Art. 120-*quaterdecies*, para. 1, TUB), its provisions are not applicable retrospectively;[66] moreover, it was often considered deprived of effective tools to combat the risk of systemic effects tied to exchange rate risks.[67]

Nonetheless, despite not being formally applicable to loans indexed to foreign currency, as they are not mentioned in the MCD, which only deals with contracts grounded on denomination mechanisms,[68] it has been claimed that its articles 23 and 24 may well represent a source upon which to base a set of claims in unjust enrichment; furthermore, some scholars held that the MCD could also be applied to old cases.[69]

Considering the similar structure that denominated and indexed contracts share, it would therefore be plausible to argue that the MCD is to be applied by analogy to the second category of agreements and, even if not, article 24 could cover both of them: uncoincidentally it broadly encompasses 'variable rate credits' where the foreign currency is used as a reference rate.

V Early Repayment and Reduction in the Total Cost of the Credit

In the recent years, the right of consumers to discharge their obligations early and the consequent reduction in the total cost of the credit have proved to be among the most controversial aspects of the Italian legal discipline on credit contracts, especially after the ground-breaking judgement rendered by the ECJ on September 2019 in the now-famous *Lexitor* case.[70]

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[66] The MCD does not apply to most part of this type of contracts that have been stipulated in Europe since it was adopted in 2014 and had to be implemented in the Member States by 21 March 2016 [see Article 42(1) MCD]; in addition, it does not apply retrospectively to loan agreements concluded before that date [Article 43(1) MCD].

[67] See, on a slightly different issue, Pistelli (2022b) 108.

[68] For a general overview, revolving around the connection between the MCD and loans denominated in a foreign currency, see Maffeis (2016) 190; Azzarri (2015) 200.

[69] Grundmann & Badenhoop (2023) 25.

[70] ECJ 11 September 2019, *Lexitor Sp. z o.o* v *Spółdzielcza Kasa Oszczędnościowo - Kredytowa im. Franciszka Stefczyka and Others*, Case C-383/18, EU:C:2019:702.

More specifically, before that important intervention of ECJ, the reimbursement due to the debtor in case of early repayment was subject to an essentially unambiguous rule in Italy, shared by regulators, case law, and scholars in application of Art. 125-*sexies* TUB (the norm with which the Italian legislator had implemented the provision contained in the ancient Art. 16 CCD 2008, dedicated to consumer credit agreements[71]).

With regard to that discipline, the majority of commentators had considered the reduction of the total cost of the credit as a plain corollary of general civil law principles inspiring the rules on undue payments, operating after the exercise of the right to early discharge by the consumer.[72] It had seemed thus logical to limit the reduction of the costs of credit to burdens and obligations which, at the moment of the early reimbursement, were still to be fulfilled according to the original contractual terms (e.g. interests not already accrued according to the agreed amortization plan), or to fees and sums entirely paid at the time of the conclusion of the deal, but referable to services meant to provide benefits to the consumer over the entire duration of the relationship.[73] The text of the original version of the already mentioned Art. 125-*sexies*, paragraph 1, TUB also appeared to be oriented in the same sense, since it was referred to a reduction '*equal to*' ('pari a') and not simply '*consisting of*' (as both Art. 16 CCD 2008 stated and 25 MCD still states verbatim) the interest and the costs for the remaining duration of the contract.[74]

A clear operational rule had thus emerged in Italian law of consumer credit, based on the distinction between so called 'up-front costs', not dependent on the agreed repayment term, and therefore not subject to reduction in the event of early reimbursement; and so called 'recurring costs', to be included in the proportional reduction of the cost of credit, since they are aimed at remunerating performances and utilities rendered by the professional throughout the entire contractual relationship.[75] This rule, constantly applied in ordinary case law and in the far more

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71 For a basic overview, Ciatti (2009) 153.

72 For an overall reconstruction of the different theoretical orientations present in Italian doctrine, see Oliviero (2014) 394.

73 Modica (2016) 306; De Cristofaro & Oliviero (2014) 343; Maugeri & Pagliantini (2013) 121; Quarta (2013) 5. For a different view, contrary to differentiation between categories of costs dependent on the undue payment rationale, see Dolmetta (2019) 649; Dolmetta & Sciarrone Alibrandi (2008) 541.

74 Maimeri (2019) 6-7.

75 Barenghi (2017) 461; Malvagna (2015) 1551.

numerous decisions rendered on the subject by the ABF,[76] was eventually formalized in the regulatory measures issued by the Bank of Italy.[77]

In light of the almost complete similarity detectable between the text of Art. 16 CCD 2008 and the rule dedicated to early repayment in the MCD (Art. 25), when the Italian legislator had to implement this latter directive it merely inserted, with a new Art. 120-*noviesdecies* TUB, a textual reference to the rule already contained in Art. 125-*sexies* for consumer credit. With this drafting technique, the legislative intention was clearly that of extending also to credit agreements relating to residential immovables the normative treatment based on the distinction between up-front (non-reimbursable) and recurring (reimbursable) costs.

Considering all the above, one can easily understand the disruptive impact assumed in the Italian system by the *Lexitor* ruling, according to which 'Article 16(1) of Directive 2008/48 must be interpreted as meaning that the right of the consumer to a reduction in the total cost of the credit in the event of early repayment of the credit includes all the costs imposed on the consumer'.[78]

Leaving aside its more direct repercussions on the consumer credit sector,[79] the publication of the ECJ's opinion has immediately given rise to an intense debate on whether the principle of law contained therein, though formally referred to the norm contained in the old Art. 16 CCD 2008, should be considered relevant and binding also with regard to the rules on early repayments of mortgage credit agreements.[80] On this crucial point, two opposing interpretative approaches have emerged in the Italian case law.

On the one hand, a number of decisions have over time endorsed the extensive, more rigorous, solution, on the ground of the evident continuity between the texts of the Arts 16 CDD 2008 and 25 MCD, and of their common protective nature, necessarily oriented in favour of the weaker party of the credit agreement.[81]

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[76] See among others, Tribunale Torino, 24 April 2018; for a complete survey of the orientations of the ABF, see Simeon (2019) 436.

[77]Order on Trasparenza dei Servizi bancari e finanziari. Correttezza delle relazioni tra intermediari e clienti. See fn. 18, in particular Ch. VI, § 5.2.1, lett. *q*, nt. 3.

[78] ECJ 11 September 2019, *Lexitor Sp. z o.o* v *Spółdzielcza Kasa Oszczędnościowo - Kredytowa im. Franciszka Stefczyka and Others*, Case C-383/18, EU:C:2019:702, para. 36.

[79] For a comprehensive reconstruction of the complex evolution of the Italian consumer credit sector after *Lexitor*, marked by a series of interventions by the Italian legislature, which have even required a ruling by the Constitutional Court, see Martino (2023) 698; Pagliantini (2023 b) 279.

[80] See Natale (2022) 79; Mezzanotte (2020) 65.

On the other hand, other litigations have been resolved proposing a restrictive interpretation of the *Lexitor* ruling,[82] justified on the grounds of the different nature of the CCD 2008 and the MCD,[83] and on the (slightly) different contents of the provisions specifically devoted to early repayment in these two pieces of legislation. In particular, Art. 25(3) MCD depicts the provision of a 'fair and objective compensation' in favour of the creditor, 'for possible costs directly linked to the early repayment' as a purely optional measure for national legislators (and not as a mandatory rule, as it is instead presented in Art. 16(2) CCD 2008). This normative element has been considered apt to mark a relevant difference from the case examined in *Lexitor*, where the ECJ explicitly considered the right of the creditor as a crucial factor to counterbalance the effects of a reduction in the total cost of the credit covering all the costs incurred by the consumer in connection with the agreement.[84]

Evidently aware that persistent reasons of legal uncertainty were inevitably linked to the referral technique by which Art. 25 MCD had been originally transposed into domestic law, in 2021 the Italian legislator formally distinguished the domestic rules on early repayment relevant in case of consumer credit from those applicable to the mortgage credit field. In more detail, Art. 11-*octies*, paragraph 1, Law 23 July 2021, no. 106, has for the first time introduced in the national system a rule specifically dedicated to the reduction of the total cost of the credit valid for consumer agreements relating to residential immovable property, explicitly reaffirming, in this sector, the criterion of reimbursement limited to the recurring costs only (Art. 120-*quaterdecies* TUB).[85]

This solution has been definitively sealed in its compatibility with the superior principles of EU law by the latest judgement of the ECJ rendered on February 2023 in the case *UniCredit Bank Austria*, which has definitively confirmed the peculiarities of the sector regulated by the MCD, clarifying that: 'Article 25(1) of Directive 2014/17 must be interpreted as not precluding national legislation which provides that the

[81] ABF Bari, 21 December 2021, no. 23408; ABF Roma, 22 February 2021, no. 4662; ABF Bari, 12 November 2020, no. 20119.

[82] ABF Napoli, 9 October 2020, no. 17588 (2021) I *Foro italiano* 358; ABF Napoli, 21 January 2021, no. 1753; ABF Napoli, 22 January 2021, no. 1887; ABF Napoli, 4 March 2021, no. 5853.

[83] As several Italian commentators have observed, the MCD is inspired by a dual soul, where the consumer protection rationale is not autonomous, or pre-eminent, with respect to that aimed at the regulation of the financial market: see Pagliantini (2014) 523; Ferretti (2014) 863.

[84] See ECJ 11 September 2019, *Lexitor Sp. z o.o* v *Spółdzielcza Kasa Oszczędnościowo - Kredytowa im. Franciszka Stefczyka and Others*, Case C-383/18, EU:C:2019:702, para. 34.

[85] See Achille (2023) 134.

consumer's right to a reduction in the total cost of the credit in the event of early repayment of that credit includes only interest and costs which are dependent on the duration of the contract'.[86]

Several commentators have criticised the choice to distinguish the legal treatment of the two areas of credit contracts,[87] especially considering that the principle of law established in *Lexitor* has been confirmed in the new CCD 2023.[88] At the same time, after the latest ECJ ruling the topic seems to have finally found, at least with respect to mortgage credit, a more stable framework in the Italian legislative landscape.

VI Instead of a Conclusion, Looking Ahead

In more recent times, the Italian scenario on the issues analysed in this chapter has become progressively influenced by the emergence of new technologies and AI. Trying to inspect the relevant future way forward, these processes seem to show a twofold incidence: (i) they will be generating a disruptive impact on the concrete functioning of traditional legal institutions and mechanisms: among many, it is the case of credit scoring (*de facto* incidence); (ii) the rules governing these areas of law are increasingly adapting to the new reality (*legal* incidence).

If the prominence of the former aspect proves to be immediately graspable, the importance of the latter is evidenced by the initiatives of the EU legislature; by way of example, the Regulation on Artificial Intelligence (AI Act),[89] together with the GDPR, will be representing the bulwark of automated credit scoring, which falls into the category of high-risk systems that has been envisaged by the AI Act itself.[90]

The practical influence that automated systems will unfold in Italy is going to be assessed soon in all likelihood; by way of example, one might wonder whether resorting to artificial intelligence systems to assess credit scoring proves fully in line with the creditor's duty of care towards its clients and, in particular, with the

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[86] ECJ 9 February 2023, *UniCredit Bank Austria AG v Verein für Konsumenteninformation,* Case C-555/21, EU:C:2023:78, para. 39.

[87] See Arroyo Amayuelas (2024) 16; Hoffmann & Samek (2023) 164.

[88] See CCD 2023, Art. 29, and Recital 70.

[89] Regulation (EU) 2024/1689 of the European Parliament and of the Council of 13 June 2024 laying down harmonised rules on artificial intelligence and amending Regulations (EC) No 300/2008, (EU) No 167/2013, (EU) No 168/2013, (EU) 2018/858, (EU) 2018/1139 and (EU) 2019/2144 and Directives 2014/90/EU, (EU) 2016/797 and (EU) 2020/1828 OJ L 2024/1689.

[90] Annex III (High-Risk Systems Referred to in Article 6(2) of the AI Act.

requirement provided for by the above-mentioned Art. 124-*bis* TUB (and in addition Arts 5 and 127 TUB).[91]

Apart from potential doubts that may be raised and even beyond the indications inferable from the activity already carried out by the EBA,[92] the Bank of Italy has already paid attention to AI, automated decision and credit scoring activity on the assumption that such intersection will be playing a pivotal role in this realm of law.[93] Furthermore, it is of interest that the trend characterising the activity of supranational and domestic courts becomes increasingly apparent, inasmuch as they are presently called to issue decisions regarding the interplay between data protection (GDPR) and credit scoring;[94] even beyond creditworthiness, Italian judgements have also examined cases based on algorithms and reputational rating.[95] This seems to be fully consistent with the above-mentioned tendency in Europe, in which analysis concerning the impact of machine learning on the IRB models are increasing significantly.

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[91] See Rabitti (2023)178.

[92] EBA, Machine Learning for IRB Models. Follow-up Report from the Consultation on the Discussion Paper on Machine Learning for IRB Models (see fn. 12).

[93] See Bonaccorsi di Patti, Calabresi, De Varti & others (2022).

[94] ECJ 7 December 2023, *SCHUFA*, Case 634/21, EU:C:2023:957.

[95] See *Corte di cassazione*, 10 October 2023, no. 28358.

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CHAPTER 8

THE REVIEW OF THE MORTGAGE CREDIT DIRECTIVE: A LITHUANIAN VIEW

Paulius Astromskis
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I The Lithuanian Mortgage Credit Landscape

EU Mortgage Credit Directive (2014/17/EU) is implemented in Lithuania through the Law of the Republic of Lithuania on Immovable Property Related Credit (the *Law*), which entered into force on July 1, 2017. This law regulates the terms and conditions for granting mortgage credit and the obligations of credit providers, credit intermediaries, and peer-to-peer lending platform operators. The supervision functions were assigned to the Bank of Lithuania, which has issued or amended numerous regulations, specifying rules in certain areas, such as the Guidelines for the Provision of Credit Related to Immovable Property,[1] Provisions for Responsible Lending,[2] Guidelines for Financial Services Advertising,[3] or Description of the Procedure for Transferring Credit Providers' Rights and Obligations under Existing Credit Agreements[4] amongst some others.

Until now, the Bank of Lithuania has listed[5] 62 mortgage credit providers, intermediaries, and peer-to-peer lending platform operators. As shown in *Figure 1* The majority (49) of mortgage credit market participants are banks, credit unions and credit intermediaries, 11 companies are registered solely as mortgage credit providers

[1] Approved by the Board of the Bank of Lithuania, 22 March 2022 Decision no. 441-65.
[2] Approved by the Board of the Bank of Lithuania, 1 September 2011 Resolution no. 03-144.
[3] Approved by the Board of the Bank of Lithuania, 22 February 2021 Decision no. 416-33.
[4] Approved by the Board of the Bank of Lithuania, 30 January 2020 Resolution no. 03-11.
[5] List of Financial market participants, published by The Bank of Lithuania, available at: https://www.lb.lt/lt/finansu-rinku-dalyviai?ff=1&market=1&type%5B%5D=24&type%5B%5D=31&type%5B%5D=25

or coupled with consumer credit services, and only 2 companies are registered as peer-to-peer platform operators, although only one of them[6] is *de facto* operational.

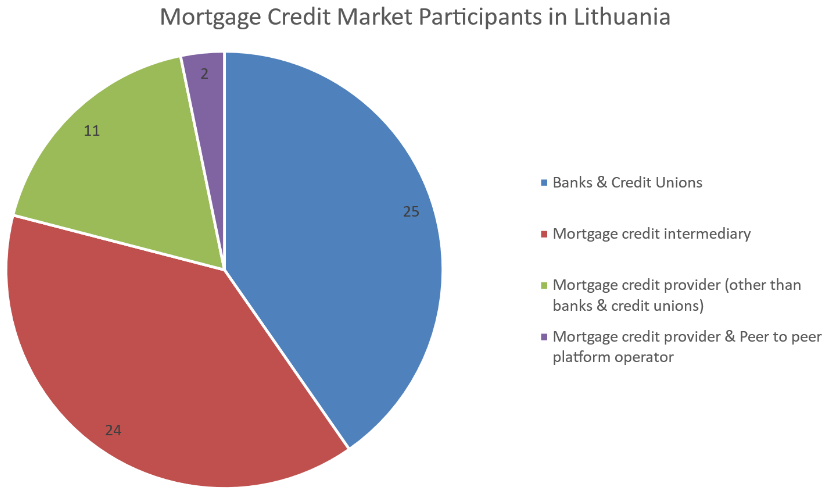

Figure 1: Mortgage Credit Market Participants in Lithuania

According to the data provided by the Centre of Registers,[7] from the entering into force of the Law, there were 130 thousand new mortgage agreements concluded by natural persons (as debtors) with legal persons (as creditors) until the end of 2023 Q2, averaging with 5.4 thousand new mortgages registered per quarter. On average, only 3 mortgage credit enforcement documents are issued per quarter, suggesting that the majority of mortgage credit defaults are being solved through other means (such as restructuring or refinancing debt), rather than employing the means of last resort.

Notably, there is a sharp increase in the sums people secure with mortgages. Since 2020-2021, the prior dominant threshold of 50K-100K EUR has been replaced with 100K-500K EUR mortgage amount, as shown in *Figures 2 and 3* below.

[6] See: UAB 'Bendras finansavimas' profile, published by The Bank of Lithuania, available at: https://www.lb.lt/lt/finansu-rinku-dalyviai/uab-bendras-finansavimas

[7] See: Open data on contracts, pledges and mortgages, published by Registry Centre, available at: https://www.registrucentras.lt/p/1561

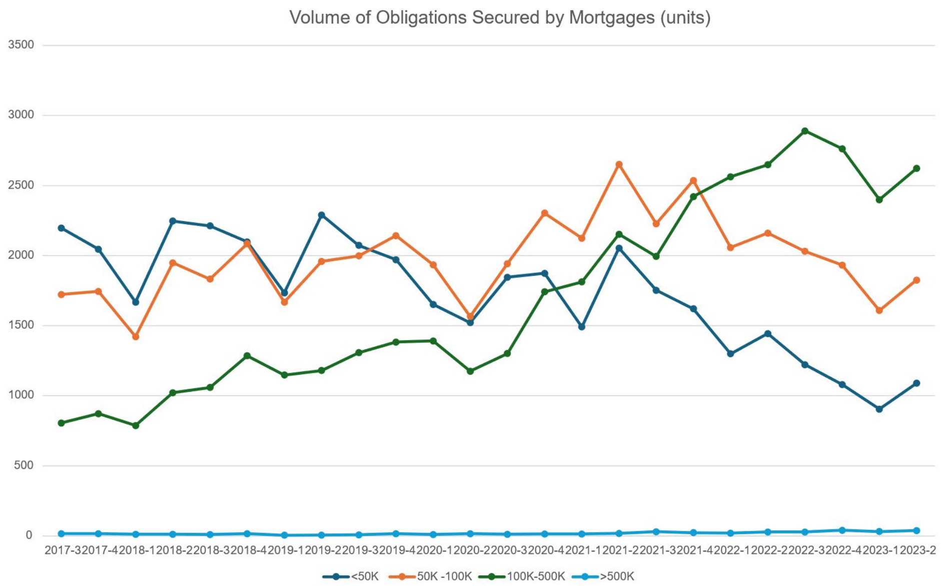

Figure 2: Volume of Obligations Secured by Mortgages (units)

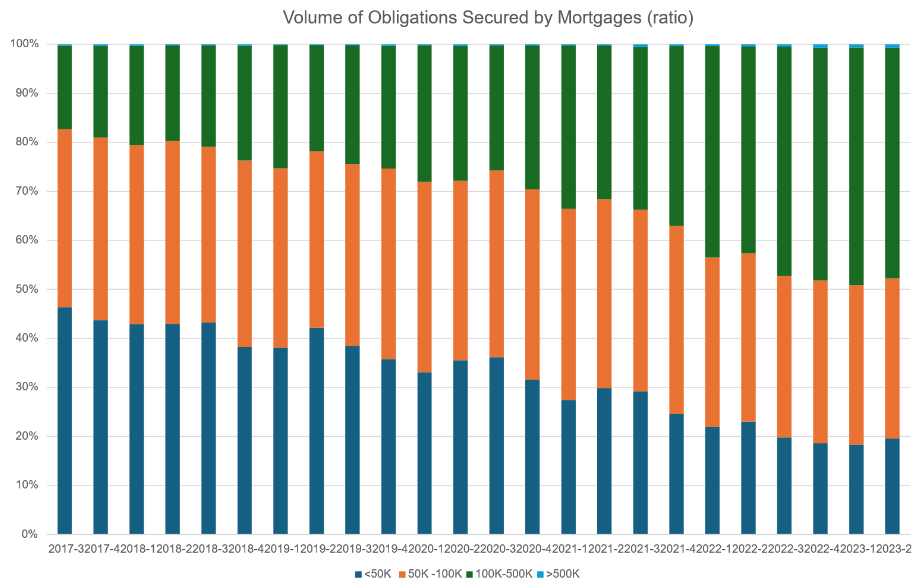

Figure 3: Volume of Obligations Secured by Mortgages (ratio)

The Bank of Lithuania (2022), in their latest Survey of the Financial Situation of Households with Loans, also noted that in 2021, the average value of newly granted housing loans increased by 11.6 thousand EUR, from 60.8 to 72.4 thousand EUR. As the value of loans increased, so did the average monthly payment and income ratio (*debt service-to-income* ratio, DSTI). For new housing loans granted in 2021, it was 27 percent. Considering the geographic distribution, the highest average value of housing loans was in the capital city of Vilnius and Vilnius county (97.7 thousand EUR), but households receiving these loans also had the highest average insurable income (3.8 thousand EUR per month). The Bank of Lithuania also noted that for the majority (70%) of households that took out housing loans in 2021, the loan-to-value (LTV) ratio was greater than 70%, and for 39% of households, it was greater than 80%, i.e. close to the maximum limit prescribed by the Provisions for Responsible Lending (85%). In 2021, the majority of new housing loans were granted to households where the average age of adult members ranged from 30 to 34 years. The total balance of housing loans at the end of 2021 amounted to 9.4 billion EUR, and the total value of the collateral was almost three times greater, totalling 27 billion EUR.

Although in general banks and other creditors are offering housing loans with both fixed or variable interest rates, the Bank of Lithuania (2022) highlighted that at the end of 2021, 92.2% of the number of all housing loans and 97.9% of their value consisted of loans with variable interest rates. Within the context of the rise in interbank interest rates in 2022, the Bank of Lithuania expressed concerns about the increased burden of obligations, especially for the most vulnerable households. At the end of 2021, there were 285,000 households with variable interest rate loans. With the rise of the interbank interest rate to 3%, the increase of an average monthly payment would account for ~2-7% of the average insurable income of these borrowers in 2021. However, the Bank of Lithuania (2022) also noted that the portion of housing loans that were either overdue or likely not to be fulfilled amounted only to 0.6% of the total value of these loans. Indeed, as shown in *Figure 4,* the share of non-performing housing loans in banks' portfolios has consistently decreased since the financial crisis and is currently at historical lows.[8].

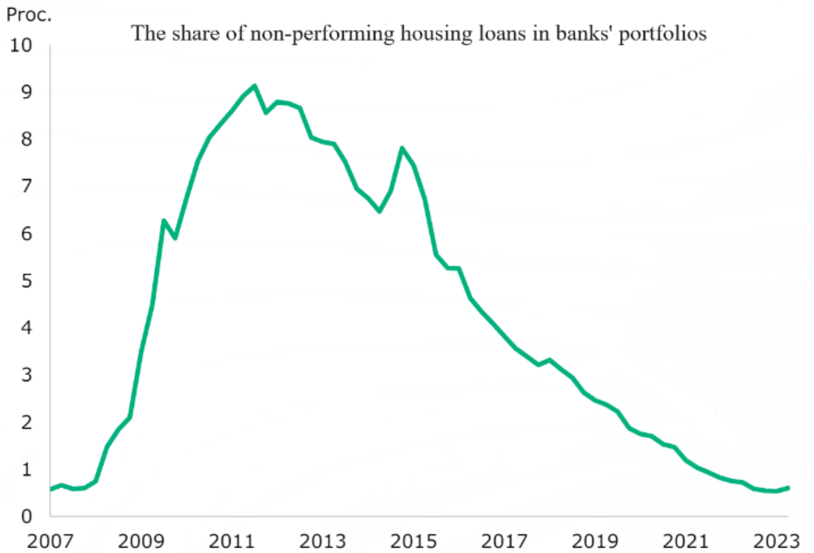

Figure 4: The share of non-performing housing loans in banks' portfolios (source: Dirma, 2023)

These high-level mortgage credit performance rates may be attributable to quite stringent Lithuanian borrower-based measures. These measures were introduced in 2011 via Regulations for Responsible Lending, as a part of a macroprudential toolkit addressing the harsh lessons of a deep recession during the Global Financial Crisis.[9]

[8] Dirma (2023).
[9] Dirma & Karmelavičius (2023) 6.

Three main borrower-based limitations are imposed on borrowers by the Regulations for Responsible Lending.

First, the loan-to-value (LTV) limit is set at 85% for the first, and 70% for the second and subsequent mortgage loans.[10] Accordingly, this measure requires a substantial down payment for a leveraged purchase of a first property or subsequent investments. Second, to safeguard borrowers from taking up excessive debt, the *debt-service-to-income* (DSTI) liquidity limit is set at 40%, with an exception for low-interest rate (5% or less) mortgage loans, where 50% DSTI is allowed. Finally, a 30-year loan maturity limit was introduced in 2015, to enhance consumer protection by requiring at least some amount of amortisation, disallowing perpetual interest payments, thus lowering the cumulative amount of interest paid by the borrower.[11] It is said that the Lithuanian LTV ratio ranks as the second strictest in Europe and with the DSTI ratio or maturity limit Lithuania is also amongst the jurisdictions with the most stringent limits (Dirma and Karmelavičius, 2023, 16). Notably, so far only one company has been sanctioned by the Bank of Lithuania for violations to assess borrowers' creditworthiness,[12] so there are no general issues with market participants' compliance.

Despite these high-level mortgage credit performance rates, the introduction and enforcement of the Law has met its own set of challenges, which can be exposed and analysed through the lens of legal disputes between market participants. The search[13] for court cases with the Law mentioned in the reasoning part of the judgement revealed that courts were mostly preoccupied with applying rules on the entry into force, implementation and application of the law (Art. 58); scope of the law (Art. 2); form and content of the credit agreement (Art. 16); termination of the credit agreement or repayment of the entire credit at the request of the creditor and the lender (Art. 23); amongst others. An overview of these issues and their solutions are presented in the next sections of this chapter.

It shall be noted that although all identified cases are important, not all of them covered or provided meaningful insights on a topic of interest. Therefore, it is not practical to read and analyse all of them in depth. Accordingly, a preview was performed, and many cases were excluded based on content, considering that review should be practically limited to cases that are most relatable and bear meaningful

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[10] With an exemption for borrowers, whose first mortgage current LTV is lower than 50% at the time the secondary mortgage is initiated.

[11] Dirma & Karmelavičius (2023) 9

[12] See: UAB 'Hipotekiniai kreditai' profile, published by The Bank of Lithuania, available at: https://www.lb.lt/lt/finansu-rinku-dalyviai/uab-hipotekiniai-kreditai

[13] Conducted using Infolex database on 20 April 2024.

insights on the practical application of the Law. Additional notes and comments have been provided from the Guidelines for Providing Mortgage Credit or other published opinions, guidelines or regulations of the Bank of Lithuania.

II Challenges Concerning Entry into Force, Implementation and Application of the Law

The majority of disputes related to the entry into force, implementation and application of the Law (Art. 58) directly related to the issues of applicability of Art. 16(6) and (7), as discussed in section IV of this overview. However, a few cases faced different challenges to the applicability of the Law.

For instance, Vilnius Regional Court was solving a civil case no. e2A-634-803/2023 on the legality of contracts for the assignment of claims arising from mortgage credit agreements. Pursuant to Art. 33(1) of the Law, a creditor has the right to transfer rights and obligations under existing credit agreements concluded with borrowers only to a person included in the public list of creditors. Art. 58(5) does not explicitly exclude Art. 33 from the general rule that the Law shall not apply to credit agreements concluded before the date of entry into force of this Law, as it is in the case of Art. 16(6) and (7). However, pursuant to Clause 2.1 of the Description of the Procedure for the Transfer of Creditors' Rights and Obligations under Existing Credit Agreements, its provisions[14] shall apply to the transfer of rights and obligations under existing credit agreements arising from the date of entry into force of this Description, irrespective of the date of the conclusion of the credit agreement, under which the rights and obligations are transferred.

The abovementioned Description was adopted pursuing the implementation mandate given to the supervisory authority under Art. 33(3) of the Law. Accordingly, it may seem that the Law provided a narrower list of exemptions that allowed retroactive application of the Law, and that the supervisory authority expanded it to include the assignment of claims arising from mortgage credit agreements. If so, it may be held that the executive branch of the government has acted *ultra vires* and unconstitutionally expanded the will of the legislative branch.

However, Art. 58(5) of the Law provides an exemption and allows retroactive application in cases where the material terms of a credit agreement concluded before the date of entry into force of this Law are amended. In this case, the provisions of this Law shall apply to the amended credit agreement. In the case at hand the court

[14] Pursuant to Clause 8 of the Description, a creditor operating under the Law may only transfer the rights and obligations under existing credit agreements to a creditor included in the public list of creditors operating under the Law. Pursuant to Clause 12 of the Description, rights and obligations under credit agreements may be transferred to a person not on the public list only if the credit agreement has expired in the cases provided for by law (e.g. termination).

concluded that, given that the credit agreement was not terminated or expired, the original creditor was the bank supervised by the Bank of Lithuania, and the new creditor is neither licensed to provide financial services nor included in the public list of creditors, the person of the creditor is of material importance to the debtor, therefore validating the applicability of Art. 58(5) and, accordingly, the Description that enabled retroactive application of the Law. Consequently, the court concluded that the bank could not have assigned the claim under the existing (not-terminated) credit agreement (concluded prior to the Law entering into force) without the applicant's consent, and thus declared the assignment null and void. Such retroactive application of the Law to the assignment of claims arising from mortgage credit agreements has also been confirmed by the Vilnius Regional Court Order on 28 March 2024 in civil case no. e2A-321-640/2024, although with a different outcome since in that case the assigned claim arose from a non-performing and terminated mortgage credit agreement.

It shall be noted that the issue of assigning performing claims (i.e. non-terminated credit agreements) drew the regulator’s attention due to the rise of marketplace platforms (e.g. Mintos) designed to crowdfund these claims by means of so-called silent assignments, i.e, when the borrower is not notified of the assignment and will continue making payments to the original creditor and maintains all rights against the original creditor; under this scenario, the original creditor would normally be a servicer of the loan and would remit the proceeds to the new creditor). Considering these practices, on 18 January 2022 the Financial Market Supervision Committee of the Bank of Lithuania issued a position on the assignment of rights of recourse under credit agreements concluded through online platforms stating that the business model, where the credit provider offers to transfer (acquire) claim rights under performing credit agreements concluded with consumers that have not been terminated to an unspecified number of persons through online platforms, is, in principle, consistent with the objective of crowdfunding to raise funds. Thus, if the creditor engages in transactions with potential risk characteristics, i.e. lending activities, it must be licensed as a credit institution. Therefore, in the opinion of the Bank of Lithuania, creditors without a credit institution's licence are not entitled to offer to transfer (acquire) claim rights of performing credit agreements concluded with consumers on internet platforms, regardless of whether the creditors offer to transfer claim rights under credit agreements concluded in the Republic of Lithuania or on an internet platform operating in another country. In other words, these transactions were generally prohibited to anyone except banks or credit unions eligible to collect deposits from the general public. However, in consideration of the financial innovations and most of these marketplace platforms getting securities brokerage licenses, the Law has been amended on 30 June 2022, allowing securitisation of these claims and consequent assignments through derivative instruments when a special purpose vehicle or any entity established outside the Republic of Lithuania takes over the rights and obligations of performing and not terminated credit agreements from the creditor, as set out in the Law of the Republic of Lithuania on Securitisation and Covered Bonds.

Another interesting case was decided by the Vilnius Chamber (Regional Administrative Court) on 4 March 2021 in administrative case no. eI2-605-541/2021. Here, the court was asked to decide whether the Bank of Lithuania lawfully refused to investigate whether a specific bank had violated the principle of responsible lending by granting credits to the applicants. Accordingly, the court faced the issue of applicability of the responsible lending obligations, which are established in the Law on Financial Institutions (Art. 31(3) part 2), Provisions for Responsible Lending and also the Law (Art. 12). The court concluded that responsible lending obligations established in the Provisions for Responsible Lending and the Law do not apply to credit decisions made before their entry into force. The Court agreed with the arguments that, prior to the entry into force of the above-mentioned provisions, mortgage credit relations were, in principle, governed solely by the general provisions of the Civil Code of the Republic of Lithuania. Hence, the court continued, the Bank of Lithuania does not supervise loan agreements concluded in accordance with the provisions of the Civil Code and is not empowered by law to supervise compliance with or application of those provisions.

The interesting part, although distant from the issues of the Law, came from the application of Art. 31(3) of the Law on Financial Institutions, which was in force at the moment of concluding the credit agreements in hand. This law established the principle of responsible lending, instructing the financial institution to ascertain the client's financial strength, thus ensuring better protection of its own interests and the financial system's overall stability. The court concluded that when lending money, a financial institution must act with prudence and care and, before granting credit, it must ascertain the financial situation of the person seeking credit and the ability of that person to fulfil his or her contractual obligations and repay the credit. The financial institution must perform this duty in good faith, in accordance with the standards of a prudent banker. Therefore, if the financial institution lends money without proper knowledge of the customer's situation and without properly assessing the borrower's solvency, the financial institution is acting unlawfully. It seems, accordingly, that despite the lack of applicability of Provisions for Responsible Lending and the Law, the principle of responsible lending has had a legal background for consumers to use it for the protection of their interests. However, the court concluded that Art. 31(3) of the Law on Financial Institutions was essentially designed to manage the risk taken by the bank and not to protect the interests of the consumer, and therefore upheld the general conclusion that the Bank of Lithuania lawfully refused to investigate the consumer's claim. Although this considerable gap in consumer protection has been filled with the adoption of the above-mentioned Provisions for Responsible Lending and also the Law (Art. 12), credit agreements concluded before their entry into force are still being unprotected by one of the major principles of consumer lending.

The last two cases[15] analysed made a straightforward application the exemption provided for in Art. 58(5) which explicitly allowed the retroactive application of Art. 23 of the Law on the termination of the credit agreement or repayment of the entire credit at the request of the creditor and the lender, which is discussed in the dedicated section V below. Accordingly, in line with the limitation on penalties under Art. 16(6) and (7), the consumer-friendly provisions on early repayment are also applicable to credit agreements concluded before the entry into force of the Law.

III. Challenges Concerning the Scope of the Law

Art. 2(1) of the Law provides that the Law shall apply (with certain exceptions) to (1) credit agreements under which the performance of the borrower's obligations is secured by a mortgage on immovable property or by a right attaching to immovable property; (2) credit agreements the purpose of which is to acquire or retain the right of ownership of land or other immovable property, whether existing or to be developed; (3) agreements or a group of agreements which, by virtue of the content and/or purpose, fall within the scope of the credit agreements referred to in points (1) and (2) stated above.

Guidelines for Providing Mortgage Credit explains that the concept of a credit agreement, as defined in the Law, is quite broad and covers any form of financing or instalment pricing, irrespective of when the ownership of the immovable property is transferred. Also, according to these Guidelines, a mortgage on immovable property is not a prerequisite for the application of the Law. This means that the Law also applies to credit where the consumer has the purpose of acquiring immovable property and where the performance of the obligations is not secured by a mortgage over it. In accordance with the above provisions of the Act, in general terms, lease-purchase, where the ownership of the immovable is acquired upon payment of the full price, falls within the concept of a credit agreement.

The Act is also intended to apply to contracts which, by virtue of the content and/or purpose, fall within the concept of the credit agreements or are designed so as to avoid the direct application of the provisions of the Law, such as in the cases of ‘rent to buy’ or ‘rent to own’ business models. These may be cases, for instance, when a 20-year lease is signed to rent an apartment when the intended purpose of the lease is to pay the price of the home and acquire it at the end of the term. Or cases when a consumer sells a home and enters into a buy-back agreement for a fixed term, during which the price of the home is paid out in rent or similar financing, etc. In the Bank of Lithuania's view, the objectives of the consumer transaction are relevant when

[15] Šiauliai Regional Court, Civil Cases Division, Order of 25 May 2020 in civil case no. 2A-333-210/2020; and Klaipėda Regional Court, Civil Cases Division, Order of 7 May 2020 in civil case no. e2A-411-796/2020.

deciding on the applicability of the Law to the transaction in question. In both of the abovementioned cases, it is reasonable to assume that the purpose of the contracts between the legal person and the consumer is to obtain financing, i.e. money to be repaid in instalments and (re)gain ownership over the immovable property. These business models are essentially equivalent to a secured credit agreement, except that, in these cases, it is the ownership of the asset that serves as security for the consumer's obligations rather than the mortgage on it. In all cases, according to the Bank of Lithuania, not only the consumer's objectives should be assessed, but also the factual circumstances, such as the legal entity's business model and operating scheme, the contracts concluded between the legal entity and the consumer, the interrelationships of the contracts, the specific terms and conditions, etc.
The majority of court disputes related to the scope of the Law (Art. 2) also involve explanations of the basic concepts of this law (Art. 3) and mandatory inclusion into the public list of creditors (Art. 25), and rise from the activities of one 'loan shark', who entered into at least 107 loan transactions whereby he lent money to natural persons, namely 75 loan agreements, at least 25 promissory notes, and also entered into at least seven loan agreements in the name of his mother.[16]

Art. 25(1) of the Law provides that a legal person is entitled to grant credit only when the supervisory authority has entered it on the public list of credit providers. Since all the above-mentioned transactions were concluded by a natural person who had not established a legal entity included in the public list of credit providers, the conclusion that loan transactions fall within the scope of the Law could render them null and void (voidable) from the moment of their conclusion. Accordingly, in the abovementioned cases, various plaintiffs have instituted multiple claims to challenge these loan agreements, promissory notes, or executive entries. Moreover, the criminal charges of illegal practice of economic, commercial, financial or professional activity were prosecuted.

These cases had multiple lines of defence, one of them being based on Art. 2(1) of the Law, which excludes from its application credit agreements under which credit is granted free of interest and any other charges. Loan agreements in these cases deliberately failed to indicate that the borrower would have to pay interest for the loan, mimicking them to be free of interest. However, it has been proved that in many transactions, the amount of the money borrowed was shown with the inclusion of interest, i.e. the loan documents did not indicate the amount of money actually lent but rather the amount of loan with interest calculated in advance. Having that established, the courts found that loans were given for consideration and therefore concluded that the exception of Art. 2(1) is inapplicable.

[16] Supreme Court of Lithuania, Criminal Cases Division, Order of 15 June 2023 in criminal case no. 2K-91-976/2023.

Another line of defence was that credit agreements were provided to persons who did not qualify as borrowers under the Law. According to Art. 3(13) of the Law, a borrower is a natural person seeking to conclude a credit agreement for personal, family, or household purposes but not business or professional purposes. That is, the Law is dedicated to protecting consumers and is not applicable to business-related loans. Within this context, the outcome of cases differed depending on whether courts found borrowers qualifying as consumers, based on the actual use of the loan, rather than the declared intentions in the agreements.[17]

All of the cases, and especially the criminal one, were also concerned with the interpretation of the 'credit provider' definition. According to Art. 3(11) of the Law, a credit provider is a person, other than a natural person and a not-for-profit legal person, who grants or undertakes to grant credit for business purposes. In case no. 2K-91-976/2023, decided by the Supreme Court of Lithuania on 15 June 2023 the court noted that it is not prohibited for a natural person to lend funds and secure a loan with a mortgage, but one may not engage in the business of lending while earning interest. That is, a natural person who concludes one or few individual loan agreements (including those secured by mortgage) with other natural persons, and does not engage in a business of lending, does not qualify as a credit provider and is not required by law to obtain a licence or to be included in the public list of credit providers.

In the present case, however, the court concluded that the entrepreneurial nature of the lending activity is demonstrated by the long period of time (more than four years) during which the loans were granted, a large number of transactions concluded, and a substantial income derived from the lending activity. Also, according to the court, the entrepreneurial nature of the illegal activity was demonstrated by the systematic and organised nature of the lending activities: information about the loans was provided on websites and in newspapers, and the infrastructure necessary for the lending business was developed. The court also took into account the camouflaged manner in which lending activities were carried out, indicating an awareness of the illegality and, therefore, a greater degree of dangerousness. Having said that, the court concluded that criminal rather than administrative liability should be imposed on the wrongdoer.[18]

In the opinion of the Bank of Lithuania, expressed in another case,[19] a business should be understood as an activity for which economic resources are used and which is

[17] See for e.g. Court of Appeal of Lithuania, Orders of 13 April 2021 in civil case no. e2A-246-1120/2021; of 23 March 2021 in civil case no. e2A-181-585/2021; of 10 February 2022 in civil case no. e2A-12-407/2022; of 7 October 2021 in civil case no. e2A-441-881/2021; of 27 October 2022 in civil case no. e2A-709-467/2022; Kaunas Regional Court, Civil Cases Division, Decision of 7 March 2022 in civil case no. e2-270-945/2022.

[18] See Supreme Court of Lithuania, Criminal Cases Division, Order of 15 June 2023 in criminal case no. 2K-91-976/2023.

intended to generate income and profit, for example in the form of interest. Other factors, such as the scale and permanence of the activity and the public offering of credit to natural persons (advertising), are also relevant to the qualification. Natural persons are prohibited from crediting consumers where the activity has entrepreneurial characteristics. Accordingly, in the opinion of the Bank of Lithuania, a natural person who, on an occasional or sporadic basis, granted credit related to immovable property to natural persons would not be considered a creditor under the Law in the absence of (a combination of) entrepreneurial characteristics. The Bank of Lithuania also noted that a random (isolated) transaction should not be understood exclusively as a single transaction. In Decision no. eI4-10161-473/2023 of 30 August 2023 of the Vilnius Chamber (Regional Administrative Court), the Court agreed with this opinion of the Bank of Lithuania and did not find any entrepreneurial spirit in a situation where the individual's loan transactions were small, few transactions were made over several years, he never publicly offered to lend money, paid all taxes on the income, and at the time of the court proceedings all loan transactions had been closed.

In interpreting the concept of entrepreneur, the Klaipėda Regional Court stated in its Decision of 31 March 2023 in civil case no. e2-275-889/2023 that this concept is an autonomous concept of EU law, which must be interpreted uniformly within the territory of the Union, regardless of the qualifications of the Member States, and that, therefore, the interpretation and application of this concept is governed by the case law of the Court of Justice of the European Union. The Court referred to the judgment of the ECJ of 4 October 2018, where the Court established a non-exhaustive and non-exclusive list of criteria that should be assessed in order to determine whether the activity in question constitutes a business activity[20]. Using those criteria, the court also failed to establish the conditions of entrepreneurial activity and did not apply the Law in a situation where a person had granted 3 loans of up to EUR 50,000 over a 10-year period.

IV Challenges Concerning Form and Content of the Credit Agreement

The majority of disputes related to the form and content of the credit agreement stem from Art. 16 (6) of the Law. This subsection provides that in cases of non-performance of financial obligations under the mortgage credit agreement, the borrower may be subject to a penalty not exceeding 0.05 per cent of the overdue amount for each day of delay, except for the cases set out in subsection 7 of this Art, as explained below. In all cases of default under the credit agreement, default interest may not be calculated for a period exceeding 180 days. No other penalties or payments may be imposed on

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[19]Vilnius Chamber (Regional Administrative Court), Decision of 30 August 2023 in administrative case no. eI4-10161-473/2023.

[20] ECJ 4 October 2018, *Komisia za zashtita na potrebitelite* v *Evelina Kamenova*, Case C-105/17, EU:C:2018:808, paras 38, 40.

the borrower for non-compliance with financial obligations under the credit agreement. Accordingly, subsection 7 of the same article provides that, in the event of termination of the credit agreement or a demand for repayment in full before the expiry of the period of the credit agreement without terminating the credit agreement, the borrower may be subject to a penalty payment not exceeding 0,015 per cent of the overdue amount for each day of overdue payments.

The initially adopted Law provided only the general limitation of penalties for the overdue amount for each day of delay. Temporal restrictions and *lex specialis* for the events of termination of the credit agreement or demand for repayment in full have been introduced with the amendments that came into force on 1 May 2019. All of these limitations have been introduced as a means to protect consumers from practices of charging excessive, hidden or predatory fees for default, thus burdening borrowers in financial hardship with even deeper and sometimes unrecoverable indebtedness. Naturally, after the introduction of these limitations, debtors (mostly) made numerous attempts to use these limitations for the agreements that were concluded before the introduction of these favourable restrictions.

The landmark resolution which has set the rule on the application of the provision of Art. 16 (6) of the Law to credit agreements concluded before the entry into force of this Law, was the Order of the Supreme Court of Lithuania adopted on 2 April 2020 in civil case no. e3K-3-72-611/2020. First, the court noted that Art. 16(6) and Art. 58(5) of the Law, which provides that Art. 16(6) shall also apply to contracts concluded prior to the entry into force of the Law, do not fall within the scope of application of the EU Mortgage Credit Directive, as the Directive does not deal with the subject matter, and, consequently, the rule laid down in Art. 43(1) of the Directive limiting the Directive's applicability to credit agreements concluded prior to 21 March 2016 is not applicable to these provisions. Also, since, pursuant to Art. 2(1) of the Directive, a State may impose additional safeguards on consumers, the limitations on the level of interest imposed by Art. 16(6) of the Law on credit relating to immovable property are not prohibited by the Directive.

However, the court noted that the national legislator has not precisely defined the scope of the retrospective application of Art. 16(6) of the Law, therefore the court undertook to ascertain its legal effects with regard to two important legal questions: (1) whether the limitation on the amount of the penalty is also applicable to the period from the conclusion of the credit agreement until the entry into force of the Law, or only to penalties calculated after the entry into force of the Law; and (2) whether it applies only to credit agreements in force, or whether it also applies to agreements terminated before the entry into force of the Law.

To answer these questions, the court analysed the 'travaux préparatoires' of the Law to conclude that the legislator intended that Art. 16(6) of the Law would apply only to legal relations falling within the scope of the Law that continued after the entry into force of the Law. Such an interpretation of the above provision would not, in the view of the court, be contrary to the principles of legal certainty and legitimate expectations and would comply with one of the fundamental principles that a law is not retrospective and would not have the effect of rendering a transaction null and void by virtue of the new mandatory restrictions, adopted subsequently to the conclusion of such transaction. The court also noted that a contrary interpretation of this provision and the application of Art. 16(6) of the Law would be unconstitutional. Based on these arguments, the court also concluded that such interpretation is also applicable to interest charged under credit agreements terminated before the entry into force of the Law.

Although the abovementioned dispute concerned the initially adopted general limitation of penalties for the overdue amount for each day of delay, its applicability to the subsequently introduced temporal restrictions and penalty caps was affirmed by the Order of the Supreme Court of Lithuania, adopted on 9 May 2022 in civil case no. e3K-3-112-823/2022. In addition, the court in this case also analysed the 'travaux préparatoires' of the Law to explain differences in penalty caps under Art. 16(6) and (7). The court noted that Art. 16(7) of the Law regulates the maximum amount of the penalty payable in the event of termination of the credit agreement or if the creditor demands repayment of the credit in full before the expiry of the credit agreement. Accordingly, the penalty has been reduced from 0,05 % to 0,015 % for each day of delay, given that the penalty in such cases is calculated on the total amount of the credit balance, which is incomparably larger than the regular instalment of the loan.

These precedents have allowed borrowers to challenge the terms of the credit agreements[21] and the chain of actions to enforce them. For instance, the Order of Vilnius Regional Court of 18 February 2020 in civil case No, e2A-152-933/2020 entailed a change in the wording of notary's executive entries issued before the Law entered into force that had already been transferred to the bailiff for compulsory recovery. Moreover, the limitations set in the Law have made an impact beyond its scope of application. In many cases, penalty caps set in the Law were used to assess whether the level of penalties is disproportionately high and therefore unfair and void, although the Law was not directly applicable to the legal relationships in hand.[22] Moreover, the Order of the Court of Appeal of Lithuania on 6 February 2020 in civil case no. e2A-61-516/2020 used not only the limitations set in Law but also their logic to reason its decision in a case where the Law was not directly applicable. The court

[21] See for e.g. Vilnius Regional Court, Civil Cases Division, Order of 7 September 2017 in civil case no. e2A-25-590/2017.

[22] See for e.g. Panevėžys Regional Court, Civil Cases Division, Decisions of 3 February 2020 in civil case no. e2A-13-544/2020; no. of 3 February 2020 in civil case no. e2A-422-513/2019; Vilnius Regional Court, Civil Cases Division, Order of 29 March 2019 in civil case no. 2A-438-656/2019; Klaipėda Regional Court, Civil Cases Division, Judgment of 19 February 2019 in civil case no. e2-737-265/2019; and others.

noted that the legislator prioritises the prompt (up to 180 days) resolution of the conflict between the creditor and the borrower, and if the lender is unable to resolve the situation quickly and decides to terminate the contract, including by requiring repayment of the full amount lent, the amount of interest allowed should be reduced from 0,05 to 0,015 per cent.

Be that as it may, the general rule is that the provisions of Art. 16(6) and (7) of the Law are applicable to credit agreements concluded prior to the entry into force of the said law only to the extent that they relate to the creation and exercise of rights and obligations of persons after the entry into force of the said Law, and only in so far as the penalties provided by the contract exceed the maximum amount of interest provided for in Art. 16(6) or (7) of the Law, and these limitations shall not apply to interest calculated for the period before the entry into force of the said Law.

V. Challenges Concerning Termination of the Credit Agreement

Art. 23 of the Law provides that the creditor shall have the right to terminate the credit agreement unilaterally or to demand repayment in full before the expiry of the term of the credit agreement only when all the following conditions are met: (1) the borrower has been informed in writing at least twice of the default or improper performance of the obligations under the credit agreement; (2) the borrower fails to perform or improperly performs the obligations under the credit agreement for a period of more than 90 days; (3) the borrower does not perform or does not properly perform the obligations under the credit agreement within the additional period of at least 30 days, which has to be provided by lender in writing after it establishes that the borrower has defaulted or failed to perform properly under the credit agreement for more than 90 days; and (4) all objective possibilities have been exhausted for securing the fulfilment of the obligations under the credit agreement.

As mentioned in the preceding section dedicated to the entry into force, on implementation and application of the law (Art. 58), two cases[23] were dedicated to the issues of retrospective application of Art. 23 of the Law, allowing its application to credit agreements concluded prior to the Law's entry into force. Other cases, however, concerned the interpretation and application of the creditors’ right to terminate the credit agreement unilaterally or to demand repayment in full before the expiry of the term of the credit agreement.

When interpreting Art. 23 of the Law, the courts usually refer to the general rule of termination for a cause, referred to in Art. 6.217 of the Civil Code of the Republic of Lithuania, integrating, therefore, the full and rich body of general legal practice and doctrine into a specific mortgage credit context. Art. 6.217(1) and (2) of the Civil Code

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[23] Šiauliai Regional Court, Civil Cases Division, Order of 25 May 2020 in civil case no. 2A-333-210/2020; Klaipėda Regional Court, Civil Cases Division, Order of 7 May 2020 in civil case no. e2A-411-796/2020.

stipulates that a party may terminate a contract if the other party fails to perform the contract or performs it improperly, which constitutes a material breach of contract. To determine whether or not a breach of contract is material, the following aspects need to be taken into account: (1) whether the injured party does not obtain substantially what it expected from the contract unless the other party did not foresee and could not reasonably have foreseen such a result; and (2) whether, by the very nature of the contract, strict compliance with the terms of the obligation is essential; (3) whether the non-performance is intentional or grossly negligent; (4) whether the non-performance gives the injured party reason to expect No future performance; (5) whether the non-performing party, who was preparing to perform or was performing the contract, would suffer a very serious loss if the contract were terminated.

According to the case law of the Supreme Court of Lithuania, the greater the gap between the promised performance and the actual performance, the greater the likelihood of a material breach of contract. The gap will be maximum in the case of total non-performance. Second, in order to determine whether strict compliance with the terms of the obligation is essential in the context of the contract, it is necessary to assess whether the non-performance of a particular term of the contract will result in the loss of the creditor's interest in the existence of the obligation. Third, in order to determine whether the failure to perform the obligation was wilful or grossly negligent, it is necessary to analyse the form of the fault of the offender in the light of the general provisions of civil liability and to decide whether the offender's fault was serious and, if serious, whether it was wilful. The greater the fault, the less the legitimate interest of the injured party in the continuation of the contractual relationship. Fourth, in order to determine whether the non-performance gives the injured party reason not to expect future performance, it is necessary to determine whether the party in breach of the contract has been passive with regard to the performance of the obligations assumed, and whether, even with the best intentions, it has the capacity to perform the contract at all. Fifth and finally, it must be assessed whether the non-performing party, which was preparing to perform or was performing the contract, would suffer very substantial losses if the contract were terminated. To be relevant, the loss should not be ordinary, but very substantial and disproportionate. All these criteria must be demonstrated by the party wishing to exercise the right of unilateral termination.[24]

Case law recognises that the Civil Code thus establishes the application of the principle of *favour contractus* (priority to the performance of the contract) in national law. This principle means that the parties must seek to preserve the contract as far as possible and use termination only as an *ultima ratio* (last resort).[25] A mere formal breach of the essential provisions of the contract provided that no adverse

[24] Supreme Court of Lithuania, Orders of 3 December 2019 in civil case no. 3K-3-374-687/2019; of 29 October 2019 in civil case no. e3K-3-321-687/2019.

[25] Supreme Court of Lithuania, Order of 26 October 2018 in civil case no. e3K-3-386-378/2018.

consequences (damages) are caused to the injured party, will normally lead to the conclusion that there has been no material breach of the contract, whereas the reliance by the injured party on such a circumstance in the context of a unilateral termination of the contract constitutes an attempt to prove a purported or spurious ground for the termination.[26] Notwithstanding this, it is also recognised in the case law that the principle of *favor contractus* cannot be absolute, so that it excludes other remedies available to the creditor.

The principle of freedom of contract guarantees the right of a party to a contract to choose and pursue the remedy that best suits its interests. This choice is often determined by the actions and conduct of the other party to the contract in the performance of its contractual obligations and, in the case of a breach of contractual obligations, by the extent and significance of the breach.[27] In determining the nature of the breach of the credit agreement, it is not only the amount of the default that must be assessed but also the totality of the other relevant circumstances which may lead to the conclusion of the existence of a basis for unilateral termination.[28]

In the context of credit relations, it should be noted that the Supreme Court of Lithuania has stated in its case law that the stability of the financial system is a public interest, and strict compliance with the terms and conditions of a loan is of fundamental importance, considering the specifics of the credit business.[29] On the other hand, the protection and defence of consumers' rights is also seen as a public interest. However, the Supreme Court of Lithuania has clarified that the additional protection afforded to consumers is intended to prevent the imposition of conditions by the stronger party, thereby seeking to restore the balance of rights and obligations between the parties. However, this additional protection does not constitute an exception to one of the most important principles of private law, *pacta sunt servanda* (contracts must be respected) and therefore does not mean that consumers may not, to a certain extent, fail to perform their obligations secured by mortgages or use the consumer protection measures granted to them by law to evade the fulfilment of their freely assumed obligations unfairly.[30]

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[26] Supreme Court of Lithuania, Orders of 27 May 2020 in civil case no. e3K-3-154-823/2020; of 26 October 2018 in civil case no. e3K-3-386-378/2018.

[27] Supreme Court of Lithuania, Orders of 17 June 2013 in civil case no. 3K-3-345/2013; of 25 July 2018 in civil case no. e3K-3-274-403/2018.

[28] Supreme Court of Lithuania, Orders of 3 December 2019 in civil case no. 3K-3-374-687/2019; of 29 October 2019 in civil case no. 3K-3-321-687/2019; of 17 June 2013 in civil case no. 3K-3-3-345/2013; of 12 May 2016 in civil case no. 3K-3-267-611/2016.

[29] Supreme Court of Lithuania, Order of 20 February 2012 in civil case no. 3K-3-58/2012.

[30] Supreme Court of Lithuania, Order of 20 February 2012 in civil case no. 3K-3-58/2012.

Taking into account these rules, the courts have justified the termination of credit agreements in situations where the debtors were in systematic breach of the agreement and were more than 90 days late (in some cases from 160 days to 4 years) and the creditor has sent multiple notices requesting the payment of the outstanding debt, detailing the amounts owed, suggesting various ways of resolving the arrears and inviting the debtor to come and discuss possible solutions, but the debtors did not respond, did not pay the arrears within the time limit set and did not seek a solution.[31] In most of these cases, the amount of the arrears was of no material significance in relation to the debtor's behaviour in dealing with the contract. In one of these cases, the debtor claimed that he had not received notices from the creditor because of a change of address, but the court held that if a person fails to comply with the obligation to notify the other party of a change of residence, the creditor is entitled to send notices to the last known address of the person's residence.[32]

In other cases, the courts have held that the termination of credit agreements was unlawful in situations where the creditors' actions were limited to sending notices of default and termination of the agreement, without seeking to preserve the contractual relationship, without contacting the debtor to ascertain the reasons for the default, and without ascertaining that the debtor would not be able to meet his contractual obligations. In such situations, the amount of the arrears or the duration of time of the proper payment of the loan was of great importance, especially if the debtor, after the termination of the contract or during the proceedings, restored its solvency and made payments, sought to preserve the parties' relationship, and communicated actively, while the creditor, on the contrary, was passive.[33] In such cases, the courts have generally found that the creditor has not exhausted all objective possibilities for securing the fulfilment of the obligations under the credit agreement prior to its termination.

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[31] Klaipėda Regional Court, Civil Cases Division, Orders of 17 September 2020 in civil case no. e2A-1057-460/2020; of 5 April 2020 in civil case no. e2A-545-656/2022; of 10 December 2020 in civil case no. e2A-1333-642/2020; Vilnius Regional Court, Civil Cases Division, Order of 6 June 2022 in civil case no. e2A-424-524/2022; Kaunas Regional Court, Civil Cases Division, Decision of 10 December 2018 in civil case no. e2A-1757-254/2018.

[32] Kaunas Regional Court, Civil Cases Division, Decision of 18 March 2020 in civil case no. e2A-342-260/2020.

[33] Vilnius Regional Court, Civil Cases Division, Order of 20 May 2021 in civil case no. e2A-1204-934/2021; Klaipėda Regional Court, Civil Cases Division, Order of 18 March 2021 in civil case no. e2A-101-538/2021; Kaunas Regional Court, Civil Cases Division, Order of 31 March 2022 in civil case no. e2A-493-924/2022.

VI Emerging Solutions and Future Challenges

As observed in the first section of this chapter, the predominance of variable interest rate mortgages in Lithuania has raised significant concerns, particularly in light of rising interbank interest rates. In response to these risks, a legislative amendment effective May 1, 2025, introduces new requirements to protect borrowers better. Under the amended Art. 7, sections 4-6 of the Law, creditors will be under the obligation to present at least two mortgage options to potential borrowers: one with a fixed interest rate for a minimum of five years and one with a variable rate. If a fixed-rate offer is unavailable, creditors must provide tools to mitigate or manage the risk of interest rate fluctuations for at least five years. These requirements will apply to creditors with a loan portfolio exceeding 50 million Euros over two consecutive quarters, ensuring that larger lenders adhere to these protections. This regulatory change aims to provide greater stability and reduce the financial vulnerability of Lithuanian households in the face of fluctuating interest rates. Although regulatory decisions have been made, the impact on borrowers and the broader mortgage market remains to be seen.

A logical addition to the abovementioned changes is yet another legislative initiative to amend the Law[34] by introducing a new streamlined refinancing process to simplify and protect borrowers' refinancing activities. This initiative, once (if) adopted, set to take effect on May 1, 2025, defines conditions under which refinancing can occur without altering the remaining loan amount or extending the mortgage period. It mandates that the same immovable property must secure a new loan and limits refinancing to once every two years. Additionally, the law prohibits lenders from charging borrowers for various administrative costs typically associated with refinancing, such as notary and registration fees, thereby reducing the financial burden on borrowers. The law also requires the initial lender to promptly provide the necessary documentation to facilitate refinancing. This initiative reflects an overall aim to enable borrowers to manage their financial obligations more effectively by making refinancing more accessible and equitable in addition to the mandatory requirements on interest rate options, as described above.

Another important legislative initiative stems from the late implementation of the Non-Performing Loans (NPL) Directive (2021/2167). Only on 24 July 2024, the Law of the Republic of Lithuania on Credit Servicers and Credit Purchasers was adopted, establishing clear guidelines and obligations for credit servicers and purchasers, ensuring transparency and accountability in handling distressed obligations. This initiative introduces mandatory licensing and supervision by the Bank of Lithuania, setting strict requirements for the conduct of these entities, particularly in protecting

[34] See Proposal for a Law of the Republic of Lithuania Amending Arts 3, 242, 37, and 58 of the Law no. XII-2769 on Immovable Property Related Credit and Supplementing the Law with Chapter IV1.

the rights of borrowers during the debt recovery process. Legal entities established in the Republic of Lithuania that began credit servicing activities before the effective date of this law and intend to continue these activities after the law comes into effect must obtain a license no later than 31 December 2024. Given this pending deadline, questions remain about the practical implementations of this new regulation and the potential impacts on the NPL market dynamics, particularly concerning the balance between efficient debt recovery and the protection of vulnerable borrowers.

Besides these and other upcoming changes, the most disruptive aspect of mortgage credit seems to be responsible lending regulations, including requirements and practices for creditworthiness assessment. As observed in the first part of this chapter, the most stringent LTV and DSTI ratios in Europe and other borrower-based responsible lending measures, designed to protect borrowers from over-indebtedness, have successfully ensured high-level mortgage credit performance rates in Lithuania. However, the downside of these achievements is limiting access to credit and, consequently, access to housing.[35] Housing, in its turn, forms an inseparable part of everyone's right to an adequate standard of living for themselves and their family, guaranteed by Art. 11 of the International Covenant on Economic, Social and Cultural Rights. That said, protecting borrowers from over-indebtedness with a 'one-size-fits-all'" approach and stringent flat-line ratios may result in under-indebtedness and violate the right to an adequate standard of living for the borrower and family. Accordingly, the real challenge of responsible lending is to direct 'one-size fits-all' regulation towards personalisation through precision in the creditworthiness assessment.

However, as the EU advances towards a more digital and data-driven economy, marked by the push for open and accessible data, and the developments of trustworthy AI, significant opportunities are emerging to revolutionise creditworthiness assessment models. The integration of AI and machine learning, coupled with enhanced data-sharing frameworks (such as the proposed Financial Data Access Regulation) holds the potential to create more precise and personalised credit assessments. Transitioning from Open Banking to Open Finance could shift the current paternalistic, flat-line limitations in lending practices towards enabling credit providers to tailor their offerings more accurately to individual borrowers' circumstances. By leveraging comprehensive and interoperable data sources, creditworthiness assessments can become more precise and reliable, ultimately fostering a more inclusive financial environment that aligns with responsible lending principles while avoiding the pitfalls of under-indebtedness.

[35] Poderys *et al.* (2024).

VII. Conclusions

In conclusion, the implementation of the EU Mortgage Credit Directive through Lithuania's Law on Immovable Property Related Credit has fundamentally shaped the landscape of mortgage lending within the country. Since its enactment in 2017, the law has spurred the development of stringent regulations that have contributed to a relatively stable and responsible mortgage credit market. The oversight by the Bank of Lithuania has maintained high compliance rates among credit providers, while the regulatory framework, notably the LTV and DSTI limits, has mitigated excessive borrowing risks. Although challenges remain, notably in legal disputes and the practical application of the law, the overall trajectory of Lithuania's mortgage credit market has been one of increased security for both lenders and borrowers. This evolution reflects a proactive approach to consumer protection and financial stability, setting a strong foundation for future developments in the mortgage credit sector.

The practical implementation and application of the Law has revealed complexities particularly in its retrospective effects and the adaptation of existing agreements to meet new legal standards. The judiciary has played a pivotal role in interpreting these nuances. Despite initial challenges in aligning old contracts with new regulations, the legal framework has shown resilience and adaptability. As evidenced by the decisions of the courts, the enforcement of these laws has been instrumental in safeguarding the principles of responsible lending and ensuring the stability of the mortgage credit market. Judicial interpretations have also been essential in delineating the boundaries of the Law, particularly concerning the issue of entrepreneurial lending. The cases reviewed reveal vigorous enforcement of the law against unauthorized lending practices. This legal scrutiny ensures that credit agreements serve their intended purpose without circumventing consumer rights or financial regulations.

Also, by imposing caps on penalties and defining clear boundaries for interest calculations in default scenarios, the law aims to shield borrowers from potentially exploitative financial practices. In this same vein, the termination of credit agreements or the demand for full repayment prior to the agreed-upon term is also designed with stringent conditions to ensure fairness and the protection of borrowers. This legislative framework aligns closely with the principles of contract law under the Civil Code, particularly emphasising the need for significant breaches and exhaustive attempts at resolution before termination can be justified. Judicial interpretations highlight a balanced approach, considering both the rights of the creditor and the protections afforded to consumers. The courts' application of these regulations underscores the importance of substantive non-compliance and the exhaustion of all remedial measures before a contract can be unilaterally terminated. This serves to maintain the integrity of contractual obligations while safeguarding the financial stability and public interest inherent in credit relationships.

In sum, the implementation EU Mortgage Credit Directive in Lithuania has significantly enhanced the stability and responsibility of the mortgage credit market. This legislation has effectively mitigated excessive borrowing risks through stringent regulations, although not without challenges. Proactive supervisory authority and judicial interpretations have played an important role, ensuring that the law not only protects consumers from exploitative practices but also maintains the financial system's integrity, setting a strong foundation for future developments in Lithuania's mortgage credit sector. And yet, the landscape of mortgage credit in Lithuania remains far from settled, as it continues to evolve with new regulations and technological advancements. It is a dynamic area, filled with yet unfolded solutions and ongoing challenges. As the market adapts to these changes, both lenders and borrowers will face new opportunities and uncertainties, ensuring that mortgage credit remains a key area of focus and development in the years to come.

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CHAPTER 9

INSIGHTS AND EXPERIENCES: THE MORTGAGE CREDIT DIRECTIVE IN THE NETHERLANDS

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I Introduction

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This chapter describes the experiences with and after the implementation of the Mortgage Credit Directive (MCD) in the Netherlands. It therefore builds upon the report by Milo in *The Impact of the Mortgage Credit Directive. Contrasting Views from Member States*, published in 2017.[1] As Milo explains, implementation took place through changes in both the Dutch Civil Code ('Burgerlijk Wetboek', DCC), the Financial Supervision Act ('Wet op het financieel toezicht', Wft), and the Decree on Prudential Supervision of Financial Groups under the Wft ('Besluit Gedragstoezicht financiële ondernemingen Wft', BGfo). Therefore, in the Netherlands, the Directive is implemented in both public (Wft and BGfo) and private (DCC) regulations. As Braspenning & Mak explain, the underlying reason for this is to have two possible ways of enforcement: a public route, where the 'Autoriteit Financiële Markten' (Dutch Authority for the Financial Markets, AFM) is the competent supervisor and enforcement authority; and a private route, where a consumer can start a procedure before the civil law judge, for example, to claim compensatory damages.[2] Furthermore, consumers can file a complaint at the 'Stichting Klachteninstituut financiële dienstverlening' (the Dutch Institute for Financial Disputes, Kifid), as will be explained.

This report focusses on the most important aspects of the implementation of the MCD in the Netherlands. These aspects were selected by a literature review and a case law study (which also included Kifid decisions). Since case law plays an important role in demonstrating the functioning of legislation and regulation in practice, both sources will play a substantial role in this contribution. It must be noted, however, that the amount of usable case law (and Kifid decisions) is limited. In the first place, the amount of published case law on this topic is limited in general. Secondly, the provisions regarding the MCD are, where it concerns the provisions in the DCC, Arts 7:118-128b, not applicable to credit agreements concluded before 21 March 2016.[3] As concerns the BGfo, these changes are not applicable to mortgage credit agreements concluded before 14 July 2016.[4] The case law that contains substantive judgments is

[1] Milo (2017) 360-381.

[2] Braspenning & Mak (2018) 82.

[3] Art. V (containing Art. 211b Transitional Act Dutch Civil Code) of the Implementation Bill (*Parliamentary Documents* 2015/16, 34292, no. 2.). See for case law, for example: Supreme Court of the Netherlands 7 October 2022, ECLI:NL:HR:2022:1388; Court of Appeal 's-Hertogenbosch 31 January 2023, ECLI:NL:GHSHE:2023:366; Court of Appeal Arnhem-Leeuwarden 29 September 2020, ECLI:NL:GHARL:2020:7801; District Court Amsterdam 15 January 2020, ECLI:NL:RBAMS:2020:802; Court of Appeal The Hague 11 October 2022, ECLI:NL:GHDHA:2022:1983, Court of Appeal Arnhem-Leeuwarden 2 April 2024, ECLI:NL:GHARL:2024:2235; District Court Amsterdam 24 April 2019, ECLI:NL:RBAMS:2019:3075; District Court Rotterdam 26 June 2019, ECLI:NL:RBROT:2019:5423; District Court The Hague 24 January 2024, ECLI:NL:RBDHA:2024:379.

[4] Art. V 'Besluit van 30 juni 2016 tot wijziging van het Besluit Gedragstoezicht financiële ondernemingen Wft, het Besluit markttoegang financiële ondernemingen Wft en het Besluit

therefore limited. These judgments are, however, illustrative, especially on the topic of early repayment. Moreover, there are also decisions in which the BGfo and/or Arts 7:118 ff. DCC are applied, although the agreement was finalised before these provisions came into force.

The themes that will be covered by this report, selected through an analysis of literature and case law, are: precontractual information; creditworthiness assessment; financial education; early repayment, and reasonable forbearance. Before focusing on these subjects, some background information regarding the Dutch mortgage market is provided. Since most literature and case law are focused on the impact of the Mortgage Credit Directive on mortgage loan contracts for consumers to buy their residence, this will also be the scope of this report, unless stated otherwise.[5]

II Background Information Regarding the Dutch Mortgage Market

In this section, some important aspects of the Dutch mortgage market will be highlighted. It is worth mentioning that this will not be an exhaustive overview of the mortgage market, since the intention is to highlight elements that make the system vulnerable in times of crisis.[6] In addition, some specific aspects of the Dutch mortgage market that are useful for this chapter will be addressed.

1 The Code of Conduct for Mortgage Loans

Some provisions that are now part of legislation as a consequence of the implementation of the MCD were previously part of the Code of Conduct for Mortgage Loans (‘Gedragscode Hypothecaire Financieringen’, GHF). The Code of Conduct for Mortgage Loans applies to every mortgage loan offered and/or provided by a mortgage lender to consumers as a standard product. This Code of Conduct is drawn up by the Dutch Association of Banks (‘Nederlandse Vereniging van Banken’, NVB) and the Dutch Association of Insurers.[7] This is therefore a form of self-regulation that contains soft law for mortgage lenders. As Mak explains, according to

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bestuurlijke boetes financiële sector in verband met de implementatie van richtlijn no. 2014/17/EU van het Europees Parlement en de Raad van 4 februari 2014 inzake kredietovereenkomsten voor consumenten met betrekking tot voor bewoning bestemde onroerende goederen en tot wijziging van de Richtlijnen 2008/48/EG en 2013/36/EU en Verordening (EU) no. 1093/2010 (PbEU 2014, L 60)’, published in *Staatsblad* (Dutch Official Gazette) 2016, 266. See for case law for example: Kifid 23 July 2020, no. 2020-1069.

[5] See, for the scope of the MCD and its implementation into Dutch law, Milo (2017), 374.

[6] For a more thorough overview of the mortgage system, Milo (2017) 360-381.

[7] See for this Code of Conduct (available in the English language): www.nvb.nl/publicaties/gedragscodes/gedragscode-hypothecaire-financieringen-code-of-conduct-for-mortgage-loans/

its wording, the GHF 'is in essence voluntary in nature: it governs mortgage loans offered and/or advanced by mortgage lenders that have entered into "the agreement for the self-regulation of a mortgage loan".'[8] The majority of mortgage lenders have subscribed to the Code of Conduct, and it is therefore considered as 'common knowledge in practice: the lenders have set a norm for the market and the industry considers the norms as guiding principles', according to Mak. Interestingly, with the transposition of this regulation into the DCC, this became hard law, and therefore impacted, for example, the competence of the mortgage lender to enforce the mortgage against the property (see below section VII). Furthermore, the Code of Conduct still contains regulations that are also relevant for the provisions of the MCD. For example, the open norm on responsible lending is specified in the GHF (see section IV.2).

2 The Dutch Institute for Financial Disputes

Kifid offers an accessible and free possibility for consumers, small businesses, and self-employed persons without employees (so-called 'zzp'ers') to file a complaint against a financial services provider, such as a mortgage lender. Kifid is an independent institute funded by financial service providers.[9] Filing a complaint at Kifid is only possible after the internal complaint procedure of the financial service provider has proved unsuccessful. Filing a complaint is free of charge, and Kifid will first try to mediate between the parties. When mediation fails, the Arbitration Commission will issue a decision. This decision can be binding (if both parties agree), and appeal is possible. Kifid is therefore a valid alternative to judicial procedure, and it can be considered a non-legal dispute resolution mechanism. In this report, the decisions of Kifid will also be taken into account, since they offer illustrative examples of the functioning of some aspects of the MCD.

3 The Mitigating Role of *Nationale Hypotheekgarantie*

An important factor to mention here is the mitigating role of the 'Nationale Hypotheekgarantie' (National Mortgage Guarantee scheme, NHG). NHG is a system of collective insurance for mortgages. This insurance is possible for mortgage loans up to the national mean of residential immovable property prices (€ 335,000, in 2024). When a mortgage loan is issued with NHG, the borrower pays a one-off commission ('borgtochtcommissie') to the NHG fund. Furthermore, the mortgage loan needs to meet the criteria for responsible lending and borrowing, as set out by the National Institute for Family Finance (NIBUD). NHG also prescribes some conditions for the

[8] Mak (2015) 421.
[9] See for more information (in English): www.kifid.nl/about/

content of the mortgage deed; for example, in case of enforcement, the proceeds will be used to pay the creditor's claim first (Chapter A2 Terms and Conditions 2024-1).[10]

The NHG system is based on a suretyship agreement (Art. 7:850 DCC). In the case of a forced sale with proceeds amounting to less than the mortgagee's claim, the mortgagee can claim the remaining amount from the 'Stichting Waarborgfonds Eigen Woningen' (the foundation behind NHG). The foundation is then obliged to pay the remaining amount. The government and municipalities support the foundation; if the 'Stichting Waarborgfonds Eigen Woningen' cannot meet its obligations, they are met (paid) by the government. NHG prescribes the conditions for suretyship in its terms and conditions. NHG also offers out-of-court payment solutions in cases of debtor payment problems that are related to divorce, disability, or unemployment.

4 Vulnerability of the System: Households with High Mortgage Debts

Stimulating homeownership has been a political goal since the end of World War II. An important aspect of this policy has been to encourage mortgage lending to buy a house. This was done, inter alia, by making interest payments tax deductible and the introduction of NHG. Mortgages therefore play a significant role in the Dutch housing market since most people use mortgage finance to buy a house: about 70% of the Dutch households own a residential property, and almost 61% of the households have a mortgage loan.[11] This percentage is notably higher than in other European countries, since on average, only 25% of the EU population has a mortgage debt.[12] Interestingly, the market share of non-banks has grown over the past few years. In 2016, 20% of new mortgage loans were financed by insurance companies and pension funds.[13] More recent data shows a non-bank market share of 70%.[14] A report by the Central Bank of the Netherlands shows that non-banks focus on financing mortgages with a long fixed-interest period of 16-20 years, and mortgages with NHG.[15]

The adverse effects of the homeownership and mortgage financing policy came to light during the global financial crisis of 2007-2013, which also hit the Netherlands. Therefore, the legislature took various measures to reduce mortgage debts, as will be explained in the section dedicated to responsible lending. Furthermore, in 2013, the

[10] These Terms and Conditions are available (in English) at: www.nhg.nl/media/rxkdvedn/v-n-engelstalig-def.pdf

[11] NVB, 'Factsheet Wonen' (2021), www.bankinbeeld.nl/app/uploads/2018/07/NVB-Factsheet-Wonen-januari-2021.pdf

[12] DNB, 'Onze hoge hypotheekschulden – risico's en oplossingen' (2021), www.dnb.nl/actuele-economische-vraagstukken/woningmarkt/onze-hoge-hypotheekschulden-risico-s-en-oplossingen/.

[13] DNB (2016) 12.

[14] NVB (2021) 2.

[15] DNB (2016) 16-17.

government reduced the possibility of mortgage interest deduction. Since then, mortgage interest is only deductible when the mortgage loan is an annuity or linear mortgage loan. Most people prefer an annuity loan, since during the first repayment period of the loan, the amount due consists of a relatively large part of interest and a relatively small part of repayment. In later years, it is the other way around.

Despite these measures, the Netherlands are still famous for their high mortgage debts; in 2023, the total mortgage debt of Dutch households increased to more than 826 billion euros.[16] The Central Bank of the Netherlands repeatedly warns about the high risks of excessive household mortgage debts.[17] Although the Loan-to-Value (LTV), as a result of *inter alia* the Temporary Decree on Mortgage Credit (see section IV.1), has gradually decreased since 2011, there is still criticism of this high LTV. For example, the Financial Stability Board states that the 'limit remains very high by international standards'.[18] Moreover, the Central Bank of the Netherlands concludes that the lending standards do not prevent households from having little disposable income after they have paid their mortgage instalments, or that households are vulnerable to sudden changes in their personal circumstances. Furthermore, there is a risk of remaining debts, if the home needs to be sold through a forced sale —for example in case of divorce— in the event that the housing prices have dropped.[19] This means that the risk of 'mortgages underwater' —an instance where the remaining balance of the mortgage loan exceeds the market value of the house—,[20] an important factor during the global financial crisis, still exists. A study by the AFM on Dutch households with mortgage contracts originated between 2012 and 2017 shows that mortgage arrears increase with increasing LTI, i.e. a LTI close to the LTI cap.[21] Out of all arrears, 30% are in the group with the highest mortgages,[22] while this group only represents 18% of all new mortgages. Furthermore, the study signals that households with high mortgages have a significantly higher risk of mortgage arrears.

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[16] Central Bureau for Statistics (*Centraal Bureau voor de Statistiek*), 'Statline. Kerngegevens sectoren; nationale rekeningen', https://opendata.cbs.nl/statline/#/CBS/nl/dataset/84097NED/table?ts=1607329979735 (last updated 25 March 2024).

[17] DNB, 'Onze hoge hypotheekschulden – risico's en oplossingen' (2021), www.dnb.nl/actuele-economische-vraagstukken/woningmarkt/onze-hoge-hypotheekschulden-risico-s-en-oplossingen/

[18] FSB (2014) 25.

[19] DNB, 'Onze hoge hypotheekschulden – risico's en oplossingen' (2021), www.dnb.nl/actuele-economische-vraagstukken/woningmarkt/onze-hoge-hypotheekschulden-risico-s-en-oplossingen/

[20] Description of mortgages underwater taken from: FSB (2014) 21.

[21] AFM (2022) 3.

[22] In this report, mortgages qualify as high mortgages when the loan is higher than the maximum loan capacity based on the standard financing norm, i.e. higher than expected based on their income. As the AFM explains, households with a higher mortgage loan than expected based on their income are central in this report. See: AFM (2022) 8. This indicates that high mortgages refer to mortgage loans where the LTI is higher than expected.

Nevertheless, the study also shows that the number of households with payment arrears is low. In 2022, less than 1% of all mortgage borrowers were in arrears.[23] In numbers, in June 2022 35.135 of all mortgages were in arrears.[24] In October 2023, this number had further declined to 29.706.[25] The AFM states that since mortgage lenders can enforce the mortgage in case of arrears, households will do anything to keep paying their mortgage instalments. In addition, the mitigating role of NHG, which will be explained below, reduces the risk of residual debt under certain circumstances significantly. Furthermore, the increasing number of annuity mortgage loans since 2013 will contribute to a reduced risk of residual debts.[26] As will be discussed below, the creditworthiness assessment also contributes to the low rates of default.[27] Finally, the broad range of risk mitigating mechanisms existing in the Netherlands, such as the social security system, also play a relevant role.[28]

III Pre-Contractual Information and Digitalisation

Concerning pre-contractual information, the MCD follows the neoclassical model of market regulation.[29] Nield describes that this model 'sees the consumer as a rational actor able to make responsible borrowing decisions best suited to his or her needs, assisted by the provision of relevant, accurate and timely comparative information'.[30] Behavioural economics, however, shows that 'mortgagors are not always well equipped to make responsible borrowing decisions'.[31] This may lead to more paternalism, as will be shown below, where the regulation concerning execution only mortgages will be addressed.

1 Implementation into Public and Private Law

The introduction of pre-contractual information duties for mortgage lenders did not bring important changes in the Dutch mortgage underwriting and origination practice.[32] In the explanatory memorandum of the legislative proposal implementing the Directive into Dutch law,[33] the legislature states that Art. 14 paras. 1 and 2 were

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23 AFM (2022) 21.
24 BKR, 'Hypotheekbarometer van Nederland' (June 2022), www.bkr.nl
25 BKR, 'Hypotheekbarometer van Nederland' (October 2023), www.bkr.nl
26 See: DNB (2020) 52.
27 Mak (2015) 426.
28 Ecorys (2021).
29 Braspenning & Mak (2015) 75.
30 Nield (2012) 167.
31 Nield (2012) 167.
32 Braspenning & Mak (2015) 73; Van Poelgeest, Marius (2016) 46; Braspenning & Mak (2018) 79-82.
33 Explanatory memorandum in this report means the *Memorie van Toelichting*, accompanying a legislative proposal, that gives a general explanation about the proposal and its legislative changes.

already part of the existing public legislation, and are now also implemented into Dutch private law, namely Art. 7:122 DCC.[34] As already mentioned in the introductory paragraph, the MCD is implemented in both public and private law norms. The obligation to provide the consumer with personalised pre-contractual information by means of the European Standardised Information Sheet (ESIS), as prescribed by Art. 14 of the MCD, is therefore laid down in Art. 4:33 of the Financial Supervision Act, Art. 11(2)(d) Decree on Prudential Supervision of Financial Groups under the Wft, which belong to the field of public regulation, and in Art. 7:122 (2) of the DCC. Furthermore, Art. 3 of the Code of Conduct for Mortgage Lenders prescribes what (pre-contractual) information has to be provided to consumers.[35]

2 Digitalisation: Execution-Only Mortgages

In its yearly report *Trendzicht*, the AFM signals important trends and risks in the financial sector. The report of 3 November 2022 mentions digitalisation and ‘platformisation’ as being part of one of the important trends.[36] One aspect of this trend is the growing offer of so-called execution-only mortgages. This development is mentioned in the report, where the risks of digitalisation are described: ‘The ease becomes so great that it becomes too easy; the lack of friction resulting in insufficient critical reflection takes place or collection of advice is omitted among price-driven consumers who choose execution only’.[37] Execution-only means that the process of taking out a mortgage is carried out online without personal mortgage advice. Therefore, consumers can save the mortgage advice fee (about 1,000 euros minimum).[38] Execution-only mortgages therefore became popular after the introduction of the ban on commissions (‘provisieverbod’) on 1 January 2013, which means that mortgage advisors may no longer accept commissions from mortgage providers to charge a mark-up on the interest rate of the mortgage.[39] As a result, consumers who no longer wish to pay for mortgage advice search for alternatives such as the execution-only mortgage.[40]

With the aim of consumer protection, the legislature took a more paternalistic approach here. As already stated above, studies in the field of behavioural finance show that ‘consumers generally do not have a sufficient level of financial literacy in

Unless otherwise stated, in this chapter references to the explanatory memorandum refer to that preceding the legislation implementing the MCD.

[34] See further about the implementation of Art. 14 MCD: Milo (2017) 375.

[35] See also Mak (2015) 421.

[36] AFM (2022) 38.

[37] AFM (2022) 38 (translation by the author, IV).

[38] Consumentenbond (2024).

[39] Kramer (2018) 5.

[40] Tuinstra & Giphart (2013) 300.

order to make informed, rational decisions'.[41] In this light, Art. 16 of the MCD prescribes that Member States must 'ensure that creditors and, where applicable, credit intermediaries or appointed representatives provide adequate explanations to the consumer on the proposed credit agreements and any ancillary services, in order to place the consumer in a position enabling him to assess whether the proposed credit agreements and ancillary services are adapted to his needs and financial situation'. When implementing the Directive into Dutch law, the legislature decided to not incorporate the obligation of adequate explanation as a separate duty.[42] Poelgeest & Masius explain that pre-contractual information was already quite extensive, which made an extra obligation unnecessary. Nevertheless, they consider that under certain circumstances, an (oral) explanation by the mortgage lender could be necessary, depending on the consumer and (special) circumstances. An example they mention is the execution-only mortgage.

Instead of an (extra) information duty, the 'Besluit Gedragstoezicht financiële ondernemingen Wft' (BGfo) prescribes in Art. (80)(e)(1) that all financial service providers who provide *inter alia* mortgage credit without advice, need to determine whether the consumer has sufficient knowledge and experience to understand the risks of the mortgage procedure before starting the underwriting process.[43] Furthermore, an obligation to warn the consumer in case of insufficient knowledge or experience is prescribed in Art. 4:24 of the Financial Supervision Act. Consumers who aim to finance their home through an execution-only mortgage need to take a compulsory so-called 'kennis- en ervaringstoets' (knowledge and experience test).[44] This test was already prescribed for financial service providers who give advice to consumers. Art. 4:23 of the Financial Supervision Act states that financial service providers need to obtain information about the financial position, knowledge, experience, objectives and risk appetite, insofar as this is reasonably relevant for their advice. According to the explanatory memorandum, the financial service provider does not have this obligation in case of execution-only services. Therefore, a test is needed to determine whether consumers can assess the risks of the financial service and product, and the consequences for their own financial situation by themselves. The aim of the obligation is to raise awareness on the part of consumers regarding their level of financial literacy and the question of whether they are capable of making

[41] Mak & Braspenning (2012) 309. See also: Nield (2012) 168-169.
[42] Van Poelgeest & Masius (2016) 48.
[43] According to para. 2, the first paragraph does not apply to mortgage credit providers who, without advising in the procedure, offer an additional mortgage credit not exceeding € 25,000 if the additional mortgage credit is demonstrably used to finance energy-saving facilities in a home and the consumer applies for the additional mortgage credit within five years of taking out the mortgage credit already established on the home and this mortgage credit was taken out with the same provider.
[44] See for an example of this test (in English): www.abnamro.nl/en/personal/mortgages/knowledge-and-experience-test.html.

a well-considered decision regarding credit.[45] Art. 80e(2) BGfo further contains the requirements to take a test.

With this test, the consumer needs to answer questions about the product and the risks, to determine whether the consumer is sufficiently aware of the risks and consequences for their situation. If the consumer fails the test, the execution-only mortgage can still be taken out, although the AFM states that in case of an insufficient test outcome 'it is wise to consider whether you would still like to have the execution-only mortgage or that you prefer the help of an adviser'.[46]

Tuinstra & Giphart raise the question of whether execution only is appropriate for mortgage lending, since this financial product has a high impact and long duration. Furthermore, when a product is more complicated, it is less likely that execution only will be used by consumers. However, they also emphasise that the tax deduction regulation, introduced in 2013, makes linear mortgages and annuity mortgages the only attractive option for mortgages concerning the residence of consumers. They state that the risks of these products can be compared to consumptive credit with a repayment plan, and there is no specific legislation for that product which prescribes that consumers should obtain further information in case of execution only. Tuinstra & Giphart conclude that when consumers choose linear mortgages and annuity mortgages, the complexity is limited. This is different in the case of a change in their current mortgage, such as a change of mortgage type.[47]

IV Creditworthiness Assessment

To prevent over-indebtedness, a creditworthiness assessment is introduced by the MCD.[48] In the Netherlands, a responsible lending policy was already developed before the implementation of the MCD, with Art. 4:34 of the Financial Supervision Act making the lender responsible for the assessment as to whether the credit is affordable for the consumer, and the elaboration of this provision in Arts 113-115 'Besluit Gedragstoezicht ondernemingen Wft'.[49] Before the implementation of the MCD, further substantiation took place in the Code of Conduct for mortgage lenders.

1 Implementation

[45] 'Besluit van 21 december 2012 tot wijziging van het Besluit Gedragstoezicht financiële ondernemingen Wft, het Besluit marktmisbruik Wft, het Besluit prudentiële regels Wft, alsmede enige andere besluiten op het terrein van de financiële markten (Wijzigingsbesluit financiële markten 2013)', published in *Staatsblad* (Dutch Official Gazette) 2013 695.
[46] AFM (not dated).
[47] Tuinstra & Giphart (2013) 300.
[48] Van Poelgeest & Masius (2016) 48.
[49] Mak (2015) 17.

In 2013, the Temporary Decree on Mortgage Credit ('Tijdelijke regeling hypothecair krediet') was introduced by the government to reduce Loan-to-Income (LTI) and Loan-to-Value (LTV) ratios.[50] As Van Poelgeest & Masius describe, with this decree the Netherlands complied with the recommendation in Recital 55 of the MCD, stating that Member States should 'issue additional guidance [...] on methods to assess a consumer's creditworthiness, for example by setting limits on loan-to-value or loan-to-income ratios and should be encouraged to implement the Financial Stability Board's Principles for Sound Residential Mortgage Underwriting Practices'.[51] Mak states that since then 'the formulation of criteria for the assessment of the borrowing capacity of a consumer is no longer a private matter'.[52] Before, this assessment was regulated by the Code of Conduct for Mortgage Loans. Now, 'supervision of the rules is placed more firmly in the hands of the AFM'.[53] The decree prescribes the maximum LTI and LTV. The LTV cap is 100%, but this percentage can change in the case of energy-saving measures.

Mak gives an overview of the contribution of the Directive to responsible lending politics, with a focus on the LTI and LTV ratios.[54] Firstly, the creditworthiness assessment in the Netherlands, especially with the focus on the LTI, is considered to contribute to responsible lending here. In the Netherlands, the LTI requirements are strict since fixed ratios are set by the norms of the National Institute for Family Finance Information (NIBUD)[55] and the 'Tijdelijke regeling hypothecair krediet'. These requirements are adjusted annually. Secondly, the LTV ratios in the Netherlands are high; at the time of Mak's article, these were in most cases higher than 100 per cent. Mak correctly states that even 'if LTI ratios are contained, it [the high LTV] does make the financial system more vulnerable to market fluctuations'. This is still true to date, although there are mitigating factors, as explained in section II.4. Mak concludes that the Dutch regime complies with the Directive on a general level. Others hold that the legislative framework, which was already in place before the MCD entered into force, offers more protection to consumers against over-indebtedness than the Directive.[56]

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[50] 'Regeling van de Minister van Financiën van 12 december 2012, kenmerk: FM/2012/1887 M, houdende de inkomenscriteria voor het verstrekken van hypothecair krediet en regels voor het vaststellen van de maximale hoogte van het hypothecair krediet in verhouding tot de waarde van de woning (Tijdelijke regeling hypothecair krediet)', published in *Staatscourant* (Dutch Official Gazette) 2012, 26433.

[51] Van Poelgeest & Masius (2016) 49 (translation by the author, IV).

[52] Mak (2015) 422.

[53] Mak (2015) 423.

[54] See for an overview Mak (2015) 426-428.

[55] See *Toelichting Gedragscode Hypothecaire financiering* (2020) 2-3 (via www.nvb.nl).

[56] Cherednychenko & Meindertsma (2014) 184.

However, some additions must be made to these conclusions. First of all, mortgage lenders have the possibility to depart from the norms in the 'Tijdelijke regeling Hypothecaire krediet', since Art. 4 introduces the 'comply or explain method', which means that departing form the norm is possible under certain circumstances and with explanation from the mortgage lender.[57] This deviation must meet strict conditions, which are also elaborated in the 'Tijdelijke regeling'. One of these conditions is, for example, that the justification for the deviation is recorded, substantiated with documents and contains calculations showing that the deviating situation has been tested based on the standards and indicating why providing the mortgage credit is justified in the specific situation (Art. 4(2)(b). Given these strict conditions, deviation is only possible in certain circumstances and only if this is justified under these circumstances.[58] Secondly, the 'Tijdelijke regeling Hypothecair krediet' is adjusted annually, based on the advice of NIBUD. Over the past years, lending standards have been relaxed. For example, since 2012 the second income in case of a couple is allowed to be counted (in steps) in the creditworthiness assessment. Since 2023, this second income is counted fully, increasing the borrowing capacity of partners.[59] In 2024, the loan capacity for 'non vulnerable single persons' is expanded.[60] Lastly, stricter control of LTV and LTI ratios also restricts mortgage credit for certain groups of borrowers.[61] Interestingly, although it is more difficult for first-time buyers to enter the owner's market nowadays, the obstacles to obtain a mortgage are not mentioned as one of the reasons. The increasing mortgage interest rate, as well as the housing prices are mentioned as important factors by DNB, while they also state that the lending norms must be tightened more, especially regarding the LTV.[62]

2 Preventing Over-Indebtedness: Refusal to Offer Credit (Extension)

Art. 18 (5) MCD prescribes that Member States shall ensure that the creditor only makes the credit available to the consumer where the result of the creditworthiness assessment indicates that the obligations resulting from the credit agreement are likely

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[57] At the time of Mak's article this was still laid down in the Code of Conduct for Mortgage Lenders.

[58] 'Regeling van de Minister van Financiën van 12 december 2012, kenmerk: FM/2012/1887 M, houdende de inkomenscriteria voor het verstrekken van hypothecair krediet en regels voor het vaststellen van de maximale hoogte van het hypothecair krediet in verhouding tot de waarde van de woning (Tijdelijke regeling hypothecair krediet), *Stc.* 2012, 26433, 6.

[59] NIBUD (2022), 31.

[60] https://www.nibud.nl/onderzoeksrapporten/rapport-advies-hypotheeknormen-2024/.

[61] See also Mak (2015) 427.

[62] DNB (2023).

to be met in the manner required under that agreement. This has been implemented in Art. 4:34 (2) of the Financial Supervision Act as a duty to refuse the credit (or the extension of the credit) in case of over-indebting the consumer. In this light, Poelgeest & Masius state that, compared to Art. 18(5) MCD, Art. 4:34 (2) of the Financial Supervision Act also prescribes a duty to refuse, but that this duty is vaguer.[63] Where Art. 18 (5) MCD prescribes that the creditor shall only make the credit available where the creditworthiness assessment indicates that the obligations are 'likely to be met', Art. 4:34 (2) of the Financial Supervision Act contains a duty to refuse in cases where this is, in view of over-indebtedness, irresponsibl*e*. Poelgeest & Masius conclude that the Dutch creditworthiness assessment is therefore broader and more consumer friendly.

3 Green Mortgages

Households that wish to make their home more sustainable have various options, ranging from subsidies to the 'Energiebespaarlening' (energy saving loan) of the 'Warmtefonds',[64] the 'duurzaamheidslening' (sustainability loan) of the 'Stimuleringsfonds Volkshuisvesting',[65] and favourable conditions for mortgage lending. The latter one will now be discussed further, since it is most related to the topic of green mortgages.

Most favourable conditions for mortgage lending to promote sustainability measures are related to the provisions in the 'Tijdelijke regeling hypothecair krediet'. From 1 January 2024, these conditions for mortgage lending contain: a link between the maximum amount of the mortgage loan and the existing energy label of the house and the possibility to borrow extra money to make the house more sustainable (with a maximum of € 20,000, depending on the current energy label). Other favourable conditions include interest reduction on so-called sustainability mortgage loans ('verduurzamingshypotheek'); an energy saving budget (which could be used to pay energy saving measures in the near future), as well as no mortgage advice fee in case of a mortgage loan for sustainability measures.[66]

Except for the condition linking the maximum mortgage loan to the energy label, these measures have in common that they are targeted to sustainability measures in the future, and that they promote (mortgage) lending to achieve that goal. One could

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[63] Van Poelgeest & Masius (2016) 51.
[64] Nationaal Warmtefonds, 'Energiebepaarlening', www.warmtefonds.nl/particulieren.
[65] Stimuleringsfonds Volkshuisvesting, 'Duurzaamheidslening', www.svn.nl/duurzaamheidslening.
[66] Consumentenbond, 'Extra hypotheek voor verduurzaming', www.consumentenbond.nl/energiebesparende-maatregelen/financieren-met-je-hypotheek (online, last updated 15 July 2024).

wonder, how this promotion of mortgage lending fits within the goals of preventing over-indebtedness and the financial regulation described above. This seems to be explicable in light of the global sustainability goals, which also affect the housing policy in the Netherlands. For example, in June 2022, the Ministry of the Interior and Kingdom Relations published the 'Beleidsprogramma Versnelling Verduurzaming Gebouwde Omgeving' (Policy program for the acceleration of the sustainability of the built environment).[67] Here, it is stated that: 'Financing sustainability with savings or through a mortgage loan will remain the most attractive and most logical option for many homeowners. Together with the Minister of Finance and the sector, I am studying how the use of the mortgage loans to finance sustainability measures can be improved.'[68] Furthermore, an explorative study commissioned by the same Ministry among homeowners shows that 'increasing the mortgage loans is seen less as taking on a new "debt". Borrowing money this way is familiar. But people do not spontaneously think of this solution and it is not accessible to everyone. Raising the mortgage is only possible for those who have sufficient borrowing capacity. Any higher monthly costs related to the mortgage could be compensated by the lower energy costs through sustainability. More awareness of this possibility could lead to more citizens feeling that they can finance the sustainability and progress the sustainability.'[69] Moreover, to facilitate the renovation of condominiums, the legislator introduced the possibility for the association of owners (who represents the individual owners) to borrow money for renovation or sustainability measures. One of the underlying goals of this legislation was also to contribute to the sustainability goals of the government.[70] Here, the legislator stated that 'research [...] has shown that there is interest among associations of owners to borrow for the purpose of sustainability measures.'[71]

This 'familiar' feeling could explain why stimulating mortgage lending is used to facilitate sustainability measures of homeowners, despite the measures over the past years to restrict mortgage lending. It must, however, be noted that in the letter that accompanied the lending norms from 1 January 2024 (which are laid down in the 'Tijdelijke regeling hypothecair krediet'), the Minister of the Interior and Kingdom Relations explained that this change was related to a motion of a Member of the House of Representatives that requested standardised norms for financial institutions concerning sustainability measures.[72] Furthermore, it could be stated that more sustainable homes (with better energy labels) are saving money on their energy bills,

[67] Ministry of the Interior and Kingdom Relations (2022).
[68] Ministry of the Interior and Kingdom Relations (2022), 33 (translated by me, IV).
[69] Independent minds (2022), 16 (translated by me, IV).
[70] Kamerstukken II 2015/16, 3 4479, no. 3, 1.
[71] Kamerstukken II 2015/16, 3 4479, no. 3, 4.
[72] Kamerstukken II 2023/24, 32 847, 1120, 2.

and therefore have more space in their budget for mortgage payments.[73] Since these measures have only been introduced this year, unfortunately not much can yet be said about their effect.

V Financial Education

Article 6 (1) MCD introduces an obligation for EU Member States to '[...] promote measures that support the education of consumers in relation to responsible borrowing and debt management, in particular in relation to mortgage credit agreements […].' As Braspenning & Mak explain, financial education is an important response to the (very) basic level of financial literacy of consumers.[74] Financial education could help promote knowledge and understanding of and experience with financial products. The knowledge and experience test prescribed in Arts 4:23 and 4:24 Wft, is an example of awareness of the legislature that financial literacy is an important component of decision making regarding financial products.[75] This knowledge and experience test is also introduced for execution-only mortgages, as explained above.

In response to Recital 29 and Art. 6(1) MCD, the legislature states in the explanatory memorandum that the Dutch consumer can gather information from various independent consumer organisations, such as the platform 'Wijzer in geldzaken' (Money Wise),[76] knowledge and advice centre in household finance NIBUD,[77] the 'Consumentenbond' (Consumers' Organisation),[78] and 'Vereniging Eigen Huis' (the Homeowners' Association).[79] Also, the financial supervisor AFM offers this type of information to consumers, the legislature states.[80] These information channels already existed before the MCD came into force, and the legislature did not take further steps to actively introduce financial schooling for consumers at the time.

The EBA 2020 report on Financial Education shows that in 2017, the Netherlands still relied on informative websites as a means for consumers to make educated decisions. The report mentions the national education initiatives, collected in the EBA internal repository. For the Netherlands, they indicate as initiatives: 'publications for consumers, website general information, financial markets information line, money wise, and consumer newsletter'. The overview of initiatives shows that other countries have more active ways of providing financial education, such as school programmes (for example Spain), events for children (Italy), financial literacy week

[73] Kamerstukken II 2023/24, 32 847, 1120, 2.
[74] Braspenning & Mak (2015) 73 and 76-78.
[75] Braspenning & Mak (2015) 76-77.
[76] See www.wijzeringeldzaken.nl/.
[77] See www.nibud.nl/about-nibud/.
[78] See www.consumentenbond.nl/.
[79] See www.eigenhuis.nl/.
[80] Parliamentary Documents II 2015/16, 34292, no. 3, 6.

and financial training via municipalities (Portugal).[81] However, on 8 June 2023, the Minister for Poverty Policy, Participation and Pensions, announced a training programme for teachers on financial education for children, as one of the measures to reduce financial problems, poverty and debts.[82] The website 'geldlessen' shows that schools can apply for a subsidy to 'for example, train teachers to offer financial education in existing subjects, hire or release staff to ensure that financial education has a structural place in schools, or organise financial counselling for students with financial problems. The money can also be used to involve parents or caregivers in their children's financial education'.[83] This programme was announced after a study by the 'Bureau voor Kredietregistratie' (Bureau for Credit Registration) found that 24,000 adolescents aged 18 to 25 had one or more payment problems. Interestingly, the website also mentions that municipalities also provide money to schools for guest lectures about money matters. These lessons, combined with more structural programmes on this topic, are 'very powerful', according to the (government's) website.

This initiative seems very promising in light of the obligation for Member States to support financial education. At this moment, the programme has just started, so unfortunately it is too early to draw any conclusions.

VI Early Repayment

Art. 25 MCD deals with the consumers' right to discharge fully or partially their obligations under the credit agreement, before the expiry date of the agreement.

In the Netherlands, this right of early repayment already existed for most mortgage loans.[84] It was provided for in Art. 9 of the Code of Conduct for Mortgage Loans, so this was a regulatory provision for all mortgage lenders before the transposition of the MCD. At first glance, the introduction of this provision seems to have a subordinate role. Nevertheless, since a serious number of homeowners make use of this right, and because of the societal discussion started by consumers' organisations regarding fair and objective compensation (Art. 25(3) MCD), the right of early repayment is worth elaborating on. Especially, the possibility to ask for compensation in case of early repayment, transposed into Art. 7:127 (3) DCC and Art. 81(c) BGfo have been part of a societal debate after a campaign of the Dutch Consumers' Organisation against so-called 'boeterentes' (penalty fees).[85] This will be explained below, after a general overview of the practice of early repayment in the Netherlands.

[81] EBA (2020) 12.
[82] Rijksoverheid (2023).
[83] See www.geldlessen.nl/subsidie/ (English translation by the author, IV).
[84] European Commission (2020) 170-177.
[85] Consumentenbond (2017).

1 Transposition into Dutch Law

Similar to Art. 14 MCD, Art. 25 MCD is transposed into private and public law norms. Art. 7:127 DCC is part of private law, while Art. 81c BGfo is part of public law. The provisions overlap where they both prescribe that consumers have a right of early repayment (para. 1), although different descriptions of this right are used, and that the compensation for the mortgage lender may not exceed the financial loss of the lender (Art. 81c(2) BGfo and Art. 7:127(3) DCC). Art. 7:127 DCC allows the lender to prescribe certain conditions for the exercise of the right to early repayment, as will be explained later. Para. 3 is the transposition of Art. 25(3) MCD and also forbids penalty fees for early repayment, while para. 4 transposes Art. 25(4) MCD into Dutch law.

Art. 81c(1) BGfo defines early repayment as the total or partial repayment of mortgage credit before the expiry date of the agreement, while para. 4 obliges the lender to hand the consumer that wishes to repay a calculation of the compensation for early repayment and the hypotheses used in this calculation. Para. 5 allows the AFM to make regulations regarding the calculation of the compensation. As will be explained below, the AFM used this competence and introduced a guideline in March 2017. Art. 81c(3) was introduced in July 2019, after discussion concerning the scope of 'early repayment', as will also be discussed below.

The provisions entered into force on different dates: Art. 7:127 DCC entered into force on 21 March 2016, and therefore applies to credit agreements concluded from 21 March 2016; Art. 81c BGfo entered into force on 1 July 2016, and is applicable to credit agreements that concluded from 1 July 2016.

2 Data on Early Repayments in the Netherlands

In 2021, an explorative survey among 2,000 homeowners by 'De Hypotheker', a large mortgage advice company with 180 offices in the Netherlands, found that 39% of these homeowners had made early repayments on their mortgage loan.[86] Interestingly, a survey of the Dutch Central Bank on voluntary repayments regarding mortgage loans in Q2 of 2019 and Q2 of 2020, shows no increase in these repayments.[87] An exception to this rule are young households (18-35 years old), that have made more repayments in Q2 of 2020 compared to Q2 of 2019. DNB states that this could be explained by their relatively high LTV and the possibility of lower

[86] De Hypotheker (2021).
[87] DNB (2020).

mortgage interest rates,[88] resulting in a reduction in financial risk regarding their mortgage loan. On average, their early repayments rose from 22,000 in Q2 2019 to 38,000 in Q2 2020.

The difference between (the outcomes of) the surveys of 'De Hypotheker' and DNB could be explained by the different approach: DNB studied the difference in repayments between Q2 of 2019 and Q2 of 2020, while 'De Hypotheker' studied early repayments in general. The results of the survey by 'De Hypotheker' are interesting to explain a bit further. As said, 39% of the homeowners responded that they have made early repayments on their mortgage loan. About 20% of them made an early payment of 5,000-10,000 euros, 17% of them have repaid 10,000-15,000 euros and 27% have repaid more than 20,000. Almost 75% of these homeowners said that they were willing to make early payments again. Although this study involved only 2,000 homeowners and is therefore not a representative sample of all households, it indicates that the right to early repayment is often used by households. The respondents also stated that the COVID-19 crisis has not played a role in their decision to make early repayments, although during the pandemic households have saved more money than ever before.[89] Interestingly, almost half of the respondents indicated that they repaid less than 10% of their total outstanding mortgage debt, since most mortgage lenders only make early repayment without compensation possible for a maximum of 10% of the outstanding loan per year.

According to Art. 25(2) MCD, Member States may provide that the exercise of the right to early repayment is subject to certain conditions. In line with this provision, Art. 7:127(2) DCC gives the mortgage lender the possibility of making early repayment only possible on certain dates, with due consideration of a certain term or terms and/or certain thresholds, or against the payment of a compensation. A quick scan on the websites of the largest mortgage lending institutions reveals that most mortgage lenders use this possibility in their agreements. Overall, most of them claim compensation if more than 10% of the outstanding loan per year is repaid. This percentage is in accordance with Art. 11 of the Code of Conduct for Mortgage Lenders 2011, where the possibility of early repayment without compensation was also capped at 10% of the original loan amount. As said, the provisions concerning early repayment in this Code of Conduct were an inspiration when the MCD was implemented. However, some institutions do not charge extra costs, or set a higher threshold, which is of course beneficial for consumers.[90] In the explanatory

[88] DNB states here that a lower LTV could result in an interest discount when renegotiating or refinancing their mortgage loan. See: DNB (2020).

[89] De Hypotheker (2024). See also: DNB (2024).

[90]Among the largest mortgage lending institutions 10% of the loan can be repaid a year without compensation. A notable exception is Rabobank, who generally uses a 20% limit. See for examples of

memorandum of the Decree that implemented Art. 25 MCD into the BGfo, the Minister of Finance stated that this threshold is part of the self-regulation of mortgage institutions, and that there is no supervision regarding this self-regulation.[91] Nevertheless, the compensation may not exceed the financial loss, as prescribed by Art. 81c BGfo.

3 Compensation for Early Repayment

Art. 7:127(3) DCC and 81c(2) concern the compensation for early repayment of mortgage loans. As already mentioned, these provisions have stirred up most dust.[92] These provisions concern early repayment, and more specifically the option Art. 25(3) MCD provides for Member States to restrict the compensation that creditors receive in case of early repayment. The Netherlands have used this regulatory option, and Mak & Braspenning explained that this led to new questions.[93] These questions regard the exact definition of financial loss ('financieel nadeel', in Dutch) and the exact scope of Art. 25 and its implementation in Art. 7:127 DCC and Art. 81c BGfo were unclear. Both aspects will be discussed below, based on literature, case law, parliamentary documents, and online websites. The latter illustrate the societal discussions that the compensation for early repayment provoked in the Netherlands.

3.1 The Definition of Financial Loss

Concerning the definition of financial loss, the legislature did not give much direction in the explanatory memorandum. The only thing mentioned here is that, in reaction to a statement by the Dutch Association of Banks and in connection with Art. 10 of the Code of Conduct for Mortgage Lenders, the compensation costs can be determined

the 10% treshold ING, 'Extra aflossen', www.ing.nl/particulier/hypotheek/jouw-hypotheek/extra-aflossen; ASN, 'Extra aflossen ASN Annuïteitenhypotheek', www.asnbank.nl/hypotheek/hypotheekvormen/asn-annuiteitenhypotheek.html; ABN AMRO, 'Hypotheek aflossen', www.abnamro.nl/nl/prive/hypotheken/mijn-hypotheek/extra-aflossen/; SNS, 'Extra aflossen op je hypotheek', www.snsbank.nl/particulier/hypotheken/hypotheek-extra-aflossen.html; Rabobank, 'Kosten extra aflossen', https://www.rabobank.nl/particulieren/hypotheek/mijn-hypotheek-of-woning-aanpassen/extra-aflossen/veelgestelde-vragen

[91] 'Besluit van 30 juni 2016 tot wijziging van het Besluit Gedragstoezicht financiële ondernemingen Wft, het Besluit markttoegang financiële ondernemingen Wft en het Besluit bestuurlijke boetes financiële sector in verband met de implementatie van richtlijn no. 2014/17/EU van het Europees Parlement en de Raad van 4 februari 2014 inzake kredietovereenkomsten voor consumenten met betrekking tot voor bewoning bestemde onroerende goederen en tot wijziging van de Richtlijnen 2008/48/EG en 2013/36/EU en Verordening (EU) no. 1093/2010 (PbEU 2014, L 60)', published in *Staatsblad* (Dutch Official Gazette) 2016, 266, 53.

[92] Braspenning & Mak (2015) 83.

[93] Braspenning & Mak (2015) 83.

by using the net present value method.[94] Furthermore, the legislature states that, in line with Art. 25, the compensation must be fair and objective, and it can only regard the costs directly linked to the early repayment. Furthermore, the compensation shall not impose a sanction on the consumer. Also, regarding legal certainty and the continuation of the current practice, the legislature explained that the method used for calculating the costs must be controllable for the consumer.

Almost one year after Art. 81c BGfo entered into force, on 10 March 2017, the AFM published the 'Leidraad vergoeding voor vervroegde aflossing van de hypotheek' (Guideline for compensation for early mortgage repayment).[95] The motive for this guideline was a study by AFM among 10 mortgage institutions on the calculation of compensation for early repayment.[96] This study led AFM to the conclusion that, although all mortgage lenders use the same method (namely the net present value), the specific calculation and variables vary among these institutions. Therefore, the AFM decided to give more steering to the mortgage industry in this Guideline. As the AFM describes, this Guideline is meant to give more direction to the mortgage industry to fulfil the requirement of fair and objective compensation and thus not charge more than compensation for the financial loss. It is, however, not obligatory to follow the calculation of the guideline; the mortgage lender is allowed to calculate the financial loss in a different way, as long as they can guarantee and demonstrate that the requirements of Art. 25(3) MCD and the Dutch legislation are fulfilled.[97]

Although it seems that the definition of financial loss has been clarified with the introduction of the AFM Guideline, incorrect calculations of compensation and/or unclarities still exist. In 2018, the AFM conducted a study on compliance with the guideline in 15 financial institutions.[98] They studied 10 files at each institution, and found that in 32 of the 150 studied files, the compensation claimed for the early repayment was too high. These excessive compensations had various causes. The AFM signals three of them: individual mistakes because of false data for the calculation; an incorrect system that provokes faults, for example by calculating incorrect interest surcharge, and incorrect approach of the financial loss, for example because of levelling up the remaining interest fixed term. Furthermore, the AFM found incomplete or incomprehensible repayment calculations. Also, a case-law study shows that the calculation of the compensation still raises questions. These judgements will be discussed below, in subsection 4.2.

[94] Parliamentary Documents II 2015/16, 34292, no. 3 65-66.
[95] AFM (2017).
[96] AFM (2017) 3.
[97] AFM (2017) 3.
[98] AFM (2018).

To date, we still see clarifications and additions to the Guideline. For example, in April 2023, the AFM published an addition to the Guideline.[99] The reason for this addition was the recent increase in mortgage interest. This provoked questions from consumers and lenders regarding the calculation of the compensation, which led the AFM to give instructions concerning this calculation. More precisely, the calculation of the comparative interest rate was clarified in the addition. In the consultation phase of the addition, some institutions stated that the implementation in their systems would take a considerable amount of time. In its reaction, the AFM states that it understands that the mortgage industry would need the entire year 2023 for implementation. At the same time, the AFM emphasises that lenders need to find a temporary solution to ensure that consumers do not pay a higher compensation than prescribed by the addition to the Guideline. This development shows not only that the calculation of the compensation still raises new questions but also demonstrates the challenges of new regulation for the automated systems of the mortgage industry. The implementation usually takes significant time since institutions need to update their systems, whilst temporary solutions need to be implemented to prevent consumers from paying disproportionate compensation.

3.2 Campaign of Consumer Organisations Against Early Repayment Penalty Fees

Interestingly, the introduction of the MCD and the Guideline also provoked societal discussion. More precisely, the 'Consumentenbond' (Consumers' Organisation) started a campaign against so-called 'boeterentes' (early repayment penalty fees).[100] According to their website, some mortgage lenders have charged more compensation than is allowed by legislation and the Guideline of the AFM.[101] This concerns compensation for early repayments that took place before the introduction of the Guideline, but also —according to the website— for repayments made after the introduction of the Guideline. Also, a Dutch television programme focused on consumers, called 'Radar', broadcasted a show about the unfair compensation costs charged in cases of early repayment. Then, Members of the Dutch Parliament asked the Minister of the Interior and Kingdom Relations about these early repayment penalties.[102] As the Minister notes correctly, these early repayment penalties were imposed on consumers with credit agreements concluded before the MCD and the AFM Guideline entered into force. Therefore, the new rules are not applicable in those cases. Also, the Minister states that the mortgage industry was still busy implementing the new calculations based on the AFM Guideline into their IT systems

[99] AFM (2023).
[100] Consumentenbond (2017).
[101] Consumentenbond (2017).
[102] 'Beantwoording Kamervragen Nijboer (PvdA), van Dijck en Kops (beiden PVV) over de uitzending van Rader over te hoog berekende boeterente' , 12 June 2017, 2017-0000100745.

at that time (June 2017). Therefore, not all calculations could take place according to the Guideline. Nevertheless, the Dutch Association of Banks and the Association of Insurers had promised to compensate consumers who had paid more compensation than prescribed after 14 July 2016.

On 29 November 2019, the Dutch Association of Homeowners ('Vereniging Eigen Huis') and the 'Consumentenbond' started a collective action against a mortgage lender, Delta Lloyd/Nationale Nederlanden, for imposing excessive penalty fees on consumers who refinanced their mortgages before 14 July 2016.[103] Since consumers who refinanced their mortgages after that date and who had paid more than the fair and objective compensation according to the MCD and the AFM Guideline will be compensated, the 'Vereniging Eigen Huis' and the Consumentenbond claimed that the other consumers must be compensated as well. Since the Directive, Art. 7:127 DCC, Art. 81c BGfo and the AFM Guideline are not applicable here, the claim was based on Art. 6:233 *sub* a DCC, which declares unfair terms voidable,[104] and Art. 6:237 *sub* 1 DCC, which contains a so-called grey list of terms that are presumed to be unreasonably burdensome for consumers. The District Court of Amsterdam decided that the term of Delta Lloyd that contained the compensation for early repayment was not an unfair term.[105] At the end of its decision, the court notices it could be that in an individual case, the enforcement of the compensatory clause could be unreasonable.

Other collective actions were more successful. On 31 December 2019, the Volksbank decided to compensate 15,000 consumers who refinanced their mortgages before 14 July 2016, after negotiations with the 'Vereniging Eigen Huis' and the 'Consumentenbond'.[106] At the same time as the collective actions of 'Vereniging Eigen Huis' and the 'Consumentenbond' started, other claim foundations were created, to start collective actions on the same topic.[107] It seems that these foundations are no longer active these days.

3.3 Scope of Art. 25 MCD, Art. 7:127 DCC and Art. 81c BGfo

Another question concerns the scope of Art. 25 MCD, where it refers to 'early repayment'. As Braspenning & Mak describe, in practice there are more shades of grey

[103] Consumentenbond (29 November 2019).
[104] 'A term in general terms and conditions is voidable if: (a) it is unreasonably onerous for the other party in view of the nature and other contents of the agreement, the manner in which the terms and conditions were concluded, the mutually recognisable interests of the parties and the other circumstances of the case [...].' (Art. 6:233 introductory words and *sub a* DCC).
[105] District Court of Amsterdam 15 January 2020, ECLI:NL:RBAMS:2020:802.
[106] Consumtentenbond (31 December 2019).
[107] Braspenning & Mak (2018) 84.

here. This raises the question whether the provisions also need to be applied in the case of refinancing (with the same, or another mortgage lender), of a change in the fixed interest period, or in the case of 'rentemiddeling', that is, interest-rate averaging. The latter could be profitable when the interest rate has declined during the mortgage loan term, and the fixed interest period does not end in the foreseeable future. After 2010, we saw a sharp decline in mortgage interest rates, and the phenomenon of 'rentemiddeling' became popular.

The question regarding the application of the provisions on early repayment compensation in the case of 'rentemiddeling' was the subject matter of some Kifid decisions. In July 2019, the Minister of Finance Wopke Hoekstra issued a Decree, introducing a new Art. 81c (3) and a new Art. 81ca BGfo.[108] With this legislative change, the provision regarding the financial loss and therefore fair and objective compensation for early repayment is also applicable in case of a change in the interest rate and the fixed interest rate term before the expiry date of the loan agreement. This clarified the applicability of the provision on early repayment to 'rentemiddeling', and therefore no longer seems an issue.

4 Case Law Regarding Early Repayment

To complete the overview of the implementation and functioning of the provisions on early repayment, this paragraph contains the results of a study of the published case law.[109] As said, consumers with complaints regarding a financial institution, can also file a complaint at Kifid. In this paragraph, we will first explain the methodology of the study, before analysing the merits of the case law and decisions.

A search of the decisions of civil courts reveals that only 18 court judgements concerning Art. 7:127 DCC are published.[110] Twelve of these are separate cases, which means that six cases are the same case in appeal or cassation. In nine of these judgements, the court found Art. 7:127 DCC not applicable.[111] Here, the credit

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[108] 'Besluit van 21 februari 2019 tot wijziging van het Besluit Gedragstoezicht financiële ondernemingen Wft in verband met de vergoeding voor de voortijdige aanpassing van de debetrentevoet bij hypothecaire kredieten', published in *Staatsblad* (Dutch Official Gazette) 2019, 93.

[109] www.rechtspraak.nl and www.kifid.nl

[110] Not all case law is published on www.rechtspraak.nl. This is discretionary competency of individual courts. See for an explanation about the publishing policy: 'Besluit sectiecriteria uitspraken databank Rechtspraak.nl', https://www.rechtspraak.nl/Uitspraken/Paginas/Selectiecriteria.aspx

[111] Supreme Court of the Netherlands 7 October 2022, ECLI:NL:HR:2022:1388; Supreme Court of the Netherlands 7 October 2022, ECLI:NL:HR:2022:1372; District Court Amsterdam 24 April 2019, ECLI:NL:RBAMS:2019:3075; District Court Rotterdam 26 June 2019, ECLI:NL:RBROT:2019:5423; District Court The Hague 24 January 2024, ECLI:NL:RBDHA:2024:379; Court of Appeal 's-Hertogenbosch 31 January 2023, ECLI:NL:GHSHE:2023:366; District Court Amsterdam 15 January

agreements were concluded before 21 March 2016 (see above). This means that only four cases are relevant to elaborate on, since Art. 7:127 DCC was applicable.[112] No actions have been initiated that were grounded solely on Art. 81c BGfo. Eight judgements included this article, but in all of these cases, the claim was accompanied by a claim based on Art. 7:127 DCC.[113]

In 27 decisions from Kifid, there was a reference to Art. 7:127 DCC. In 14 of these decisions, Art. 7:127 DCC was not applicable because the credit agreement was concluded before 21 March 2016.[114] Interestingly, in four of these cases, the banks were following the AFM Guideline nonetheless. This led to the application of Art. 7:127 BW and the Guideline by the Commission in two of these cases.[115] As will be elaborated in the next section, these Kifid decisions mostly concern the calculation of the compensation for early repayment (Art. 7:127(3) DCC and the Guideline).

4.1 Unfair Terms

In some of the cases where Arts 7:127 DCC and 81c BGfo were not applicable, because the credit agreement was concluded before 21 March 2016, the consumer based the claim on the unfair terms of the credit agreement, Art. 6:237 *sub* i DCC. As mentioned before, this article contains a so-called grey list. These terms are presumed to be unreasonably burdensome for consumers if they are included in the terms and conditions of the agreement (this is when they are not negotiated with the

2020, ECLI:NL:RBAMS:2020:802; Court of Appeal The Hague 11 October 2022, ECLI:NL:GHDHA:2022:1983; District Court Limburg 13 June 2018, ECLI:NL:RBLIM:2018:5616.

[112] District Court Noord-Holland 9 November 2023, ECLI:NL:RBNHO:2023:11347; District Court Midden-Nederland 20 July 2020, ECLI:NL:RBMNE:2020:2847; Court of Appeal Amsterdam 11 May 2021, ECLI:NL:GHAMS:2021:1365; Supreme Court of the Netherlands 7 October 2022, ECLI:NL:HR:2022:1370.

[113] District Court Midden Nederland 20 July 2020, ECLI:NL:RBMNE:2020:2847; District Court Zeeland-West-Brabant 1 November 2023, ECLI:NL:RBZWB:2023:7713; Court of Appeal Amsterdam 15 December 2020, ECLI:NL:GHAMS:2020:34:76; District Court Amsterdam 24 April 2019, ECLI:NL:RBAMS:2019:2888; District Court The Hague 24 January 2024, ECLI:NL:RBDHA:2024:379; Court of Appeal Amsterdam 11 May 2021, ECLI:NL:GHAMS:2021:1365; District Court Midden-Nederland 20 June 2018, ECLI:NL:RBMNE:2018:2747; District Court Midden-Nederland 25 April 2018, ECLI:NL:RBMNE:2018:1642.

[114] Kifid 10 July 2019, 2019-462; Kifid 11 March 2019, 2019-152; Kifid 14 May 2018, 2018-242; Kifid 8 May 2018, 2018-232; Kifid 23 April 2018, 2018-194; Kifid 10 April 2018, 2018-173; Kifid 13 March 2018, 2018-123; Kifid 13 December 2017, 2017-844; Kifid 13 December 2017, 2017-843; Kifid 12 December 2017, 2017-818; Kifid 3 November 2017, 2017-737; Kifid 31 October 2017, 2017-700; Kifid 13 October 2017, 2017-656; Kifid 30 August 2017, 2017-567.

[115] Kifid 12 December 2017, 2017-818; Kifid 30 August 2017, 2017-567.

consumer).[116] *Sub* i states that the obligation of the consumer to pay a fee when the agreement is terminated for other reasons than a failure to comply with the agreement is presumed to be unreasonable. An exception is made for fair compensation for incurred losses or lost profits by the user of the terms and conditions.

Art. 6:237 *sub* i DCC provides a presumption for the benefit of the consumer. This is where this article differs from Art. 7:127(3) DCC, as also the District Court of Limburg recognises.[117] Art. 7:127(3) DCC prohibits the use of such penalty fees entirely, putting the consumer in a better procedural position. Of course, the consumers still have to prove that the fee qualifies as such a penalty fee, but they do not have the burden of proving that it is unreasonably burdensome.[118] Prohibiting such penalty fees also means that it is impossible for the mortgage industry to put forth the counterargument that the fee is reasonable. Because of this, from the perspective of the consumer, a claim based on Art. 7:127(3) DCC is preferred over a claim based on Art. 6:237 *sub* i DCC.

4.2 Early Repayment Penalty Fees

As mentioned before, almost all of the Kifid decisions concern the calculation of the compensation by the mortgage lender.[119] In most of them, the mortgage lender used a certain method of calculation of the compensation that the consumer claimed to be incompatible with Art. 7:127 DCC and, more specifically, with the Guideline. In all cases, this claim was rejected. The Dispute Commission of Kifid emphasised here that the mortgage lender is not compelled to use the net present value method ('netto contante waarde methode'), as proposed in the Guideline.[120] As mentioned in section VI.3.1, according to the Guideline, the mortgage lender is allowed to use another method to calculate the compensation, as long as this compensation does not exceed their financial loss.[121] Furthermore, in some decisions, we see a reference to the threshold of 10% of the mortgage loan that can be repaid without compensating for the financial loss. This means that compensation can only be claimed for the amount above this threshold.[122]

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[116] Beschikking van de Minister van Justitie van 22 november 1991, houdende plaatsing in het Staatsblad van de tekst van de Boeken 3, 5, 6 en 7 van het Burgerlijk Wetboek , zoals deze met ingang van 1 januari 1992 zal luiden (Stb. 1991/600).

[117] District Court Limburg 13 June 2018, ECLI:NL:RBLIM:2018:5616.

[118] Both articles allow a reasonable compensation for financial loss. The mortgage institution has to prove that this is the case, see: District Court Amsterdam 24 April 2019, ECLI:NL:RBAMS:2019:3075.

[119] 24 out of 27 judgements in which Art. 7:127 DCC is mentioned, are about the calculation of compensation. The other four regarded the application of Art. 7:127 para. 4 DCC.

[120] AFM (2017) 4.

[121] A commonly used and approved method is the loan-to-value method. See, for example, Kifid 28 October 2019, 2019-010A; Kifid 20 February 2019, 2019-088; Kifid 14 May 2018, 2018-238.

[122] Kifid 25 February 2022, 2022-0128; Kifid 27 July 2020, 2020-596.

The Kifid decisions show that, within the framework of fair and objective compensation, mortgage lenders have a broad discretion to calculate their financial loss in the event of early repayments. This is in line with the prescriptions in the Guideline. In one case, the Commission explains that the calculation is an estimation of future losses and profits, depending on developments in the financial market. This means that the risk of the mortgage lender charging the consumer more than the financial loss always exists. The lender is, however, not obliged to calculate all individual aspects in order to prevent this from happening.[123] The provision of necessary information about the calculation, prescribed in Art. 7:127 para. 4 DCC, seems to be more of a hurdle than the calculation of the financial loss.[124]

Other disputes concerning the calculation of the compensation lead to discussions on the other factors that should be included in the calculation. Here, the Kifid seems to decide primarily in favour of the mortgage lenders as well. For example, interests paid for a life insurance (that is a guarantee for the repayment of the mortgage loan, and that serves as a pledge for the mortgage lender) do not have to be included in the compensation.[125]

5 Interest-Only Mortgages

Related to the theme of early repayment is that of interest-only mortgages. Because of tax incentives existing before 2013, these mortgages became quite popular at that time. In 2013, the legislature implemented a new tax regulation, which changed this incentive, and which made it more attractive to make monthly repayments. Nevertheless, a survey by 'De Hypotheker' shows that interest-only mortgages became popular again over the past years, especially among homeowners aged younger than 35. This popularity can be explained by the increased housing prices and relatively modest mortgage interest rates.[126]

In 2017, interest-only mortgages (or the so-called 'beleggingshypotheken', where no repayments of the principal are made during the mortgage loan term), accounted for almost 55% of all mortgage debt in the Netherlands.[127] Both DNB and AFM repeatably expressed their concerns about these types of mortgages, since there is a risk that homeowners will not be able to repay the loan at the end of mortgage loan term.[128]

[123] Kifid 20 February 2019, 2019-088, para. 4.4.
[124] See, for example, Kifid 21 June 2022, 2022-0597.
[125] Kifid 19 September 2019, 2019-681; see also Kifid 19 March 2019, 2019-201.
[126] De Hypotheker (2022).
[127] DNB (2017).
[128] AFM (not dated); DNB (2017).

Since the term of most of these mortgages will end between the years 2035 and 2040 the AFM, DNB and ECB have not only raised more awareness among these homeowners and mortgage lenders, but they also have developed a method for mortgage lenders to calculate the risks and to confront mortgage borrowers at risk, in order to give them suitable solutions. To this end, the AFM published a hand-out for mortgage lenders in 2021.[129]

The exact risks of these interest-only mortgages also depend on the economic circumstances at the time of the end date of the mortgage loan. Developments in housing prices, interest, unemployment, and pensions are relevant factors.[130] Nevertheless, the timely and concrete measures of DNB, ECB and AFM is an example of the awareness of the risks that still exist for mortgage borrowers, and also of the need for supervisors to step in to prevent financial catastrophes for the future.

VII Reasonable Forbearance

Art. 28 MCD is implemented into Art. 7:128(a) DCC. Here, we see an example of gold-plating, since the latter provision does not just prescribe reasonable forbearance, but also that in case of arrears concerning the credit agreement, the lender cannot notify the debtor (which is the official start of the enforcement procedure) unless at least two months have elapsed since the loan became due and the mortgage lender has invited the consumer personally to discuss the arrears, except if this cannot be reasonably required of the mortgage lender. This provision is based on Art. 15 of the former Code of Conduct for Mortgage Loans.[131] Furthermore, the invitation to discuss the arrears follows the Guideline 'Betalingsachterstanden bij hypotheken. Voorkomen en oplossen van betalingsachterstanden in het belang van de klant' of the AFM, that prescribes a meeting with the consumer to come to a solution as a starting point in case of mortgage arrears.[132]

Interestingly, this provision not only prevents enforcement as much as possible, but also has consequences for the powers of the mortgage lender. As the legislature states in the explanatory memorandum, the mortgage lender cannot enforce if this provision has not been complied with.[133] This means that a forced sale where this provision has not been followed is invalid because of the lack of power on the part of the mortgage lender. Art. 7:128(a) para. 1 DCC makes an exception for cases in which 'this cannot be reasonably required of the mortgage lender'. According to the explanatory

[129] AFM (2021).
[130] AFM (not dated).
[131] Parliamentary Documents II 2015/16, 34292, no. 3, 69.
[132] AFM (2013). See also: Biemans (2017) 182.
[133] Parliamentary Documents II 2015/16, 34292, no. 3, 69.

memorandum, this exception is applicable to cases where the mortgage lender cannot contact the consumer (for example, because the contact details are unknown or outdated), the legal debt restructuring or insolvency procedure has been applied, or another creditor has seized the property.[134] In addition to Art. 7:128a DCC, which is the private law transposition of Art. 28 MCD, Art. 81d BGfo also prescribes that consumers in arrears need to be handled with care by mortgage lenders. This is the public law implementation, which is significantly less detailed than its private law counterpart.

1 The Duty of Care of Mortgage Lenders

Although Art. 7:128a DCC is more detailed than Art. 28 MCD (and Art. 81d BGfo), the provision can be considered the bare minimum of the duty of care of mortgage lenders in case of arrears. This can already be deduced from the Guidelines on arrears and foreclosure of the EBA, which *inter alia*, prescribe that the creditor should provide support to consumers in payment difficulties (guideline 3) and illustrates which forbearance measures could be applied (guideline 4). Moreover, a study by the AFM on mortgage payment arrears in 2021 found that multiple mortgage lenders can improve their forbearance policy.[135] This also derives from the EBA Peer Review Report on the treatment of mortgage borrowers in arrears, where the challenges in implementing the aforementioned EBA Guidelines are described:

'NL identifies some areas where providers may improve, and therefore can be considered as challenging, such as pre-arrears management, effective solutions addressing borrowers' specific needs, dealing with harrowing situations, residual debt management, and customer communication.'[136]

The AFM Guidelines address these five aspects for mortgage lenders The Guidelines provide concrete recommendations, which the AFM 'expects mortgage lenders to follow up'. Furthermore, good and bad practices are handled, as are the expectations of the AFM to implement effective processes that prioritise the customer's interest.[137] This report, together with the EBA Peer Review Report, suggests that there is room for improvement regarding forbearance policies among mortgage lenders. At the same time, the exact implementation is left to mortgage lenders, which have their own internal debt management procedures. This complicates research on compliance with the forbearance measures prescribed by Art. 7:128a DCC, Art. 81d BGfo, and the Guidelines of the EBA and AFM. Also, it is difficult to deduce the approach of

[134] Parliamentary Documents II 2015/16, 34292, no. 3, 70.
[135] AFM (March 2022). Unfortunately, the results of the study itself are not published.
[136] EBA (2023) 17.
[137] AFM (March 2022) 3.

mortgage lenders from case law, since the enforcement procedure is an out-of-court-procedure, as will be explained in the next subsection. Nonetheless, the AFM Guidelines on this topic indicate that not all mortgage lenders take their forbearance duties into account in case of arrears.

2 The Way Forward

The Non-Performing Loans (NPL) Directive amends Art. 28 MCD, and further details forbearance measures.[138] This Directive has not been implemented in the Netherlands yet. Moreover, the implementation is still in the preparation phase,[139] which means that the Bill implementing the Directive is currently in the making. A preliminary version of the Bill has been placed online[140] where the public can comment on the instrument prior to the Bill being presented to Parliament. The concept of the Bill does not include a provision that transposes Art. 28(2) of the Non-Performing Loans Directive into Dutch regulation. The accompanying explanatory memorandum contains no further explanation on this topic.

Currently the forbearance measures in the Netherlands are left to self-regulation of the mortgage industry, and especially to the individual mortgage lenders themselves. Apart from the bare minimum prescribed in Art. 7:128a DCC mortgage lenders have broad discretion in their solutions in case of arrears. Looking at the implementation of the NPL Directive, this remains unchanged. Which measures are used, in which cases they are used, and to what extent they are successful, is difficult to find out, since there is no public data available on this topic. Furthermore, if a mortgage loan is backed by NHG, and payment problems related to either divorce, disability or unemployment arise, NHG offers or finances out-of-court solutions for the debtor. The solutions available via NHG are: a work or budgeting coach; the 'Woonlastenfaciliteit' (a payment pause, offered by the creditor and backed by NHG); a 'haircut' (a one-time payment by NHG, designed to lower the monthly mortgage payments); repayment of the remaining debt in case of sale to the lender, or financing the remaining debt to create a new mortgage.[141]

How mortgage lenders deal with borrowers in arrears is especially interesting in the Netherlands. Legislation handles the mortgage lender a powerful tool: if the mortgage loan becomes due, the mortgage lender may start the enforcement proceedings

[138] Art. 28 Non-Performing Loans Directive (Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU L 438/1.

[139] wetgevingskalender.overheid.nl/Regeling/WGK014084

[140] See https://www.internetconsultatie.nl/kredietservicers/b1

[141] For more information, see: www.nhg.nl/english-summary/

immediately and sell the property via a public auction before a notary or via a private sale with approval of a judge. To start the proceedings, there is no judicial intervention needed. Since 1992, the mortgagee is entitled by law to sell the property as soon as the debtor is in default; the so-called right of 'parate executie'. In 2016, Art. 7:128a DCC added a two-months waiting period for the mortgagee, as described before.

Only when the mortgagee, the mortgagor or the creditor that seized the property wants to conclude a private sale, judicial approval is needed. This out-of-court procedure also means that there is no judge involved to check for irregularities, or to decide whether enforcement is used as the last resort. A judicial decision supervising whether measures to prevent enforcement were available and to what extent they were used successfully is therefore not a standard part of the mortgage enforcement proceeding in the Netherlands. The only possibility for a judge to decide on these matters is that the debtor starts a so-called 'enforcement dispute' ('executiegeschil'), whereby the debtor claims that the mortgage lender abuses its rights (Art. 3:13 DCC), that the termination of the loan agreement is unacceptable to the standards of reasonableness and fairness (Art. 6:248 DCC), or that the enforcement cannot take place according to the duty of care for processional mortgage lenders (Art. 4:25 Wft).[142]

In this context, another EU Directive may become interesting for the Netherlands; the Unfair Contract Terms Directive.[143] It seems that there is no case law in the Netherlands yet on this topic. From this perspective, one could wonder whether the fact that consumers need to take action to safeguard their rights should be revised in the light of Art. 47 of the Charter of Fundamental Rights. This Article safeguards the right to an effective remedy before a court for the violation of rights deriving from EU law.[144] This is a question outside the scope of this report, but interesting enough for further debate on this topic. Nevertheless, it seems that claims based on unfair contract terms regarding mortgage loans are currently not often brought forward in the case law. This could be considered surprising, given the judgements of the ECJ about acceleration clauses in the light of the Unfair Contract Terms Directive. In November 2023, the Court stated that:

'If, on the basis of the criteria set out above, the referring court were to find, in its assessment of the unfairness of the acceleration clause, that, in the present case, the right stipulated in favour of VÚB to claim early repayment of the outstanding balance due under the credit agreement at issue, secured by the family home of the applicants

[142] See for more information: Visser (2023) 115 ff.
[143] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (UCT Directive).
[144] See also: Van Duin (2022).

in the main proceedings, allows that seller or supplier to exercise that right without having to take account of the extent of the consumer's failure to fulfil obligations in relation to the amount granted and the duration of the loan, that finding could lead that court to find that that clause is unfair, in so far as it would create a significant imbalance to the detriment of consumers, contrary to the requirement of good faith, having regard to all the circumstances in which that contract was concluded and of which the seller or supplier could have been aware at the time it was concluded.'[145]

These kinds of clauses also exist in mortgage loan contracts, and it will be interesting to see whether these cases could trigger more case law in the Netherlands. Looking at the way forward, the Unfair Contract Terms Directive therefore seems to open more possibilities for mortgage borrowers who wish to stop or postpone enforcement, than the (not yet implemented) NPL Directive.

At the same time, these developments could also negatively impact mortgage enforcement proceedings. The balance between a swift and effective procedure for the benefit of both the mortgage lender and the borrower on the one hand, and the protection of the borrower against an unnecessary forced sale of their residence, remains difficult to reach. An exchange of best practices in this context could provide all parties involved with relevant information, for the benefit of effective forbearance measures *and* enforcement proceedings.

VIII Overall Analysis

The implementation of the MCD did not bring significant changes for the Netherlands. Nevertheless, some aspects could be identified as important topics that are (also) covered by the MCD. Based on an analysis of case law from courts, decisions from Kifid and literature on this topic, this report identified the following matters as the ones that draw most attention: precontractual information, creditworthiness assessment, financial education, early repayment and reasonable forbearance. Of these themes, the early repayment, more specifically the calculation of the fair and objective compensation, stirred up most dust in the Netherlands. Nevertheless, because of the limited temporal scope of the implemented regulations, and because of the broad discretion mortgage lenders have based on regulations and the AFM guidelines, all claims of consumers were dismissed by the courts and Kifid. Regarding financial education, the recent attention for this topic on a governmental level seems promising to attain more financial literacy on the part of the consumer. Financial literacy is also important when the challenges posed by digitalisation are analysed. In this report, the

[145] ECJ 9 November 2023, *SP & CI v. Všeobecná úverová banka a.s.*, Case C-598/21, EU :C :2023 :845, para. 86.

developments regarding execution-only mortgages were identified as an important challenge. Furthermore, this report also touches the point of the difficulty to become a homeowner as a young adult in the Netherlands. This seems more a problem of increased housing prices, combined with an increasing mortgage interest rate, than a problem caused by (the implementation of) the creditworthiness assessment. Moreover, this report mentions the concerns of different supervisors regarding the high LTV in the Netherlands. Nevertheless, mortgage arrears are relatively low as a result of the creditworthiness assessment, combined with mitigating instruments, such as NHG and the social security system. Lastly, the challenges regarding forbearance measures and the absence of prescribed court involvement in the Netherlands, were discussed in the light of the MCD, the NPL Directive, and the developments regarding the UCT Directive. This report emphasises the need for a balance between a swift and effective procedure for the benefit of both the mortgage lender and the borrower on the one hand, and the protection of the borrower against an unnecessary forced sale of their residence. Here, an exchange of best practices between Member States could be an instrument to reach such a balance.

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CHAPTER 10

CONSUMER PROTECTION AND FOREIGN CURRENCY MORTGAGE CREDIT FROM THE PERSPECTIVE OF TRANSPOSING THE MCD 2014/17 IN POLAND

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I Introduction

The enactment of the Mortgage Credit Directive 2014/17 (MCD) was an important step towards establishing a desirable and comparable level of providing consumer protection in the field of residential mortgages granted in EU markets. The overarching and ambitious aim of MCD was to integrate EU national markets for mortgage credit and to achieve a high level of consumer protection.[1] Although initial MCD proposals focused on consumer protection through pre-contractual information requirements, methods of calculating the annual percentage rate, or early repayment options, in the aftermath of the global financial crisis of 2007-2009 it quickly became clear that the MCD needed to effectively minimize the risk of consumers' becoming over-indebted with home loans. Thus, the scope of provisions contained in the initial MCD proposal was significantly expanded to ensure the promotion of responsible lending and borrowing.[2]

At the time when the MCD came into force, Poland did not have comprehensive or unified provisions on credit secured on immovables. Instead, a series of statutes were in force and in varying degrees found application to mortgage lending.[3] These included, among others, the Act of 29 August 1997 —Banking Law (BLA),[4] Act of 12

[1] Bruloot, Callens & De Muynck (2019) 42.
[2] Josipović (2014) 235-236.
[3] Habdas (2017) 407.
[4] Consolidated version Journal of Statutes 2023, item 2488, as amended.

May 2011 on consumer credit (CCA)[5] (transposing Directive 2008/48), Act of 21 July 2006 on the supervision of the financial market.[6] In addition, the National Financial Authority ('Krajowy Nadzór Finansowy', NFA) had issued various guidelines, such as Recommendation S on good practices in managing mortgage loans and amended Recommendation T on good practices in managing the risk of retail credits.[7] Various possibilities of implementing the MCD were thus contemplated. The initial idea was to create a new statute on credit agreements for consumers regarding residential immovable property, but it was abandoned in favour of enacting legislation encompassing all types of consumer credits. Ultimately, however, the legislator decided to return to the original idea and not to incorporate provisions on credits relating to immovables into the act on consumer credit, but to draft a separate act, which would cover all issues mentioned in the MCD. As a result, the Act of 23 March 2017 on mortgage credit and supervision of mortgage credit intermediaries and agents (MCIA 2017)[8] was enacted, roughly a year after the transposition date of 21 March 2016 had passed.

When considering the reasons for the adoption of the MCD, perhaps those identified in its recital 4 are of particular relevance to Poland, since numerous consumers had taken out foreign currency credits '[…] in order to take advantage of the borrowing rate offered but without having adequate information about or understanding of the exchange rate risk involved. Those problems are driven by market and regulatory failures as well as other factors such as the general economic climate and low levels of financial literacy.'

In the light of the above, the purpose of this paper is twofold. Firstly, it will identify the most important changes and improvements that the transposition of the MCD has effected in relation to mortgage credit obtained by consumers in Poland. These are predominantly connected with regulating the activities of mortgage credit intermediaries, tying and bundling practices, as well as ensuring the consumers time to reflect on their decision regarding mortgage credit. The most important, novel legal solutions in Polish law will be presented to show that the MCD has improved, as anticipated by the EU lawmaker, the standard of consumer protection on the mortgage credit market. The implementation process has also alerted the Polish legislator to the unsatisfactory level of consumer protection and provided motivation to take into account the baseline situation, resulting in the introduction of more protective solutions compared to MCD standards, which were needed. Secondly, foreign currency mortgage loans will be considered. The latter have been and continue to be the object of numerous court cases, which focus on the consequences

[5] Consolidated version Journal of Statutes 2023, item 1028, as amended.
[6] Consolidated version Journal of Statutes 2024, item 135, as amended.
[7] See https://www.knf.gov.pl/dla_rynku/regulacje_i_praktyka/rekomendacje_i_wytyczne/rekomendacje_dla_bankow?ArtId=8522&p_id=18.
[8] Consolidated version Journal of Statutes 2022, item 2245, as amended.

of identifying unfair contract terms in such agreements. Unfortunately, the issue of foreign currency loans that had already been granted remains a significant legal struggle, as courts scramble to adjudicate thousands of cases presented to them, while the national lawmaker stubbornly chooses to remain silent on this clearly systemic failure, despite the long noted need to intervene.[9] The paper will show a surprising immaturity of Polish courts, for which effectively providing consumer protection to foreign currency mortgage credit borrowers in accordance with European standards, has proven an uphill battle.

II Regulating Activities of Mortgage Credit Intermediaries

The European lawmaker's stipulation that one of the problems of mortgage markets is '[…] *ineffective, inconsistent, or non-existent regimes for credit intermediaries and non-credit institutions providing credit for residential immovable property*' (MCD, recital 4) could easily be applied to the Polish mortgage credit market, where before the implementation of the MCD, credit intermediaries were not under the supervision of the NFA and there were no requirements regarding knowledge, training or skills of persons performing intermediary and advisory activities in the mortgage credit market, nor were these persons obliged to have civil liability insurance.[10] As a result, clients were exposed to entities that did not have the necessary knowledge or ethical principles to provide responsible mortgage credit intermediary or advisory services. Their main focus was to maximize their income from commission paid by banks for selling mortgage loans and, unsurprisingly, this led to numerous adverse effects, such as indiscriminately offering loans in foreign currency as well as loans the value of which exceeded the borrower's repayment capacities, loans with an LTV ratio above 100%, loans tied to investment products, including long-term ones, or to insurance and investment instruments, loans with high fees for early contract termination.[11]

In the light of the above it is more than justified to state that there was a lot of room for improvement and the MCD was the much-needed incentive to address the shortcomings of the credit mortgage market. The deficiencies of services offered by mortgage credit intermediaries could not be overlooked also because their prevalence was growing. The sale of mortgage credits through intermediaries amounted to 20% in 2006, while ten years later, in 2016, that number more than doubled and attained the level of 45%.[12] Therefore the lack of adequate knowledge, skills and ethics on the part of mortgage credit intermediaries and advisors negatively influenced the safety of borrowers, particularly consumers, in the mortgage credit market.

The MCIA 2017 introduced numerous novel solutions in the market of mortgage loans. Regarding the activities of mortgage credit intermediaries, an important

[9] Komar (2022) 66.
[10] Wieteska, Kowalczyk-Rólczyńska & Czajkowska (2018) 297.
[11] Waliszewski (2016) 193-194.
[12] Waliszewski (2017) 8.

development was to include them in the realm of NFA supervision, with the aim of ensuring that their activities comply with MCIA 2017 (Art. 69(2) MCIA 2017). In order to achieve this aim, the NFA may issue recommendations and take measures necessary to prevent violations of consumer rights that follow from the Act. In addition, it may request written or oral information and data necessary to facilitate compliance of the mortgage credit intermediary's activities with the provisions of the Act (Art. 69(3) MCIA 2017). The NFA also has powers to fine mortgage credit intermediaries, suspend their activities, revoke the licence to practice and remove them from the register of mortgage credit intermediaries (Art. 69(3) MCIA 2017). These prerogatives follow from the NFA's new competence to issue licences to operate as a mortgage credit intermediary and to maintain a register of those professionals. Mortgage credit intermediaries cannot commence their operations without obtaining the mentioned licence and being entered into the register (Art. 48(1) 1 MCIA 2017).

As stated above, before the MCD implementation, mortgage credit intermediaries did not have to fulfill any requirements regarding their education, knowledge or skills. The MCIA 2017 has changed this situation and, following Art. 9 MCD, it has introduced the obligation of passing a competence and knowledge exam by persons wishing to become mortgage credit intermediaries. The examination is organized by a special Committee set up within the NFA and the legislator has indicated topics that it should cover, including legal aspects of consumer protection, credit agreements, mortgages and land registers, principles of creditworthiness assessment, as well as matters relating to finance, economics and business ethics (Art. 53 C).

Mortgage credit intermediaries are now also obliged to be covered by a civil liability insurance (Art. 55 MCIA 2017), the conditions of which are regulated in the Ordinance on mandatory civil liability insurance of credit intermediaries.[13] The minimum guarantee sum of third party liability insurance, for a period not longer than 12 months, is the PLN equivalent of EUR 460,000 in relation to one event, the consequences of which are covered by the insurance, and EUR 750,000 in relation to all such events. Notably, the insurance does not cover contractual penalties and, unsurprisingly, losses the credit mortgage intermediary's activities cause to his/her close family members, but it is not excluded if damages are caused negligently or intentionally by the mortgage credit intermediary or its appointed representatives and its scope cannot be contractually restricted by the insurance company.[14]

Last but not least, in relation to advisory services, the Polish legislator has decided that they can only be provided by the creditor, mortgage credit intermediaries or their appointed representatives (Art. 25(1) MCIA 2017) and has prohibited, in accordance with the possibility indicated in Art. 22(4) MCD, using the term 'advice', 'advisor', or

[13] Ordinance of the Development and Finance Minister of 19 July 2017, Journal of Statutes 2017, item 1403.
[14] Wieteska, Kowalczyk-Rólczyńska & Czajkowska (2018) 305-306.

similar terms when the advisory services are being provided to consumers by creditors, tied credit intermediaries or appointed representatives of tied credit intermediaries. Furthermore, the use of the terms 'independent advice' or 'independent advisor' is only available to credit intermediaries or their appointed representatives who are not tied and do not receive remuneration from the creditor, whether in money or in any other form of financial benefits (Art. 25(2) and (3) MCIA 2017). In this context it should be noted that the mortgage credit intermediary is obliged, before commencing the provision of their services, to inform the consumer about commissions and other remuneration in the form of money or other agreed forms of financial benefit, as well as their amount, if known, transferred by the lender or other entities to the mortgage credit intermediary or appointed representative, including remuneration related to concluding a mortgage credit agreement with the consumer. In addition, the consumer must also receive information on fees paid directly by him or her to the mortgage broker or agent for the services provided, and if it is impossible to determine this fee, information on how it is calculated (Art. 17(1), points 6 and 7 MCIA 2017).

The mentioned regulations of mortgage credit intermediaries are nothing short of revolutionary in the Polish market, and even though informing the consumer about commissions and other remuneration of the credit intermediary has been considered controversial and problematic in practice,[15] the solutions introduced do facilitate transparency in the market of mortgage credit intermediaries and increase the security of consumers, as well as allow advisory and independent advisory services to develop.[16]

III Increased Consumer Protection and Mortgage Creditors

When implementing the MCD, the Polish legislator did not shy away from gold-plating and decided to utilize the possibilities offered by the EU lawmaker of adopting solutions which are more protective for the consumer than the required minimum harmonization. Although in 2013 the Polish government introduced a Resolution of the Council of Ministers No. 13/2013 of 22 January 2013 entitled 'Lepsze regulacje 2015' (Better regulations 2015), which addressed the need to carefully consider whether gold-plating is beneficial to the proper implementation of EU Directives and desirable form the point of view of Polish social and economic interests, it seems that the Polish legislator is not averse to gold-plating.[17] It should also be mentioned that Poland has chosen to implement 22 optional provisions, thus taking third place after Greece and Cyprus, which implemented 27 and 23 of these provisions, respectively.[18]

[15] Rogoń (2017) 28.
[16] Waliszewski (2017) 16.
[17] Jabłoński (2017) 88.
[18] European Commission (2020) 38.

Leaving aside the assessment of whether and to what extent gold-plating is justified (it is viable to argue that a particular situation in an EU Member State may require the introduction of more stringent solutions than suggested in an EU Directive, especially when the safety of the consumer on the financial market leaves a lot to be desired in the light of various unfair and exploitative practices utilized by financial institutions)[19] in the case of MCIA 2017 increased levels of consumer protection, in comparison with the minimum MCD requirements, have been adopted with regard to: the types of entities that may provide mortgage credit (Art. 4 point 8 in connection with Art. 5), offering mortgage credit in foreign currency (Art. 6(1)), the prohibition of tying practices (Art. 9(1)), the reflection period during which the creditor is bound by the offer (Art. 14(6) and (7)). In addition, the Polish legislator has utilized recital 14 to regulate matters that fall beyond the scope of the MCD, including the obligation to reimburse fees and other costs collected from the consumer if the credit loan agreement was not ultimately concluded or the loan was not paid on time (Art. 15) as well as rules regarding maximum interest (Art. 41).[20]

In should also be noted that the pre-contractual information obligations were limited in Polish, national law, so implementing the MCD has had a visible impact on improving the consumers' opportunities of making a well-considered and informed decision.[21] In addition, Polish consumer organizations have expressed the opinion that the MCD's requirements for advertising and marketing have been correctly implemented and are effective in promoting good lending and borrowing practices.[22]

The Polish legislator has indicated what entities are entitled to grant mortgage credit. Pursuant to Art. 5 MCIA 2017, 'business activity the subject of which is granting or promising to grant mortgage credit to a consumer may only be carried out by creditors'. The latter are defined in Art. 4 point 8, according to which creditors include national banks, branches of foreign banks, credit institutions or their branches, all within the meaning prescribed in BLA provisions, as well as cooperative savings and credit unions. Consequently, mortgage credit as defined in the MCIA 2017 may not be offered to consumers by entities other than those mentioned above. Entities which do not meet the MCIA 2017 requirements may still offer loans, even where connected with the encumbrance of residential immovable property, as long as they are not offered to consumers or do not meet the remaining elements of the mortgage credit definition.[23] It is therefore imperative to note that pursuant to Art. 3(1) MCIA 2017 a mortgage credit agreement is one where the creditor grants or promises to grant a loan to the consumer which is secured by a mortgage or another right related to residential immovable property or intended to finance the acquisition or maintenance of the following assets, unrelated to a business or farming activity: 1) ownership of a

[19] Rutkowska-Tomaszewska (2019) 20-21.
[20] Czech (2019a) 18-19.
[21] European Commission (2020) 139.
[22] European Commission (2020) 121.
[23] Heropolitańska & Nierodka (2019) 90.

residential building or residential unit in a condominium scheme, as well as their construction or reconstruction; 2) a cooperative proprietary right to a unit; 3) ownership of land or part thereof; 4) a share in the co-ownership of a residential building, residential unit in a condominium scheme, or land. The legislator explains in Art. 3(2) MCIA 2017 that a mortgage credit agreement may, in particular, take the form of a bank loan contract, an ordinary loan agreement, a deferred payment, a credit in which the lender assumes an obligation to a third party and the consumer takes on the obligation to return the granted loan to the lender, a revolving loan.
In essence, the MCIA 2017 allows offering mortgage credit to consumers only by businesses who are subjected to the supervision of the NFA or an analogous entity of another EU Member State.[24] This is a more restrictive approach than the one adopted in the CCA, where no limitations as to the type of businesses that may act as lenders within the meaning of that act have been introduced (Art. 5 point 2 CCA). They may be natural or legal persons, as well as the so-called defective legal persons.[25] However, with respect to lending institutions (sometimes referred to as para-banks), as defined in Art. 5 point 2a CCA, the legislator has introduced a requirement that they function either as stock companies or limited liability companies with a supervisory board, in both cases with their share capital covered exclusively in monetary contributions and equal to no less than PLN 1 million (approx. EUR 250,000).[26]

IV Consumer Protection in Tying and Bundling Practices

Prior to the implementation of the MCD, Polish legislation did not have rules on bundling and tying practices. Currently, their definitions are contained in Art. 4 points 18 and 19 respectively MCIA 2017 and are almost an exact repetition of Arts 4(26) and (27) MCD. In Art. 9(1) MCIA a prohibition on tying practices, in line with Art. 12(1) MCD, has been introduced. The EU legislator establishes the prohibition of tying practices with the aim of preventing creditors from forcing consumers to acquire additional services in order to obtain mortgage credit.[27] Therefore, in recital 25 MCD it is stated that:

> '[…] tying practices should not be allowed unless the financial service or product offered together with the credit agreement could not be offered separately as it is a fully integrated part of the credit, for example in the event of a secured overdraft.'

The first exception allowed in the MCD and the MCIA 2017 are tying practices pertaining to opening a payment or savings account, which according to MCIA 2017, but not the MCD, has to be free of charge, the sole purpose of which is 1) accumulating funds to repay a mortgage credit, 2) servicing mortgage credit, or 3) providing the

[24] Czech (2019a) 136.
[25] Ofiarski (2014) 109-111.
[26] Czech (2023) 120-121.
[27] Rogoń (2015) 176.

creditor with additional security in the event of arrears in credit repayment (Art. 12(2)(a) MCD[28]; Art. 9(1) MCIA 2017). The second exception relates to requiring that the consumer holds or takes out an insurance policy related to the credit agreement or transfers to the creditor the rights under that policy, simultaneously informing the consumer that they may select any insurance provider as long as the insurance policy has a level of guarantee equivalent to the one required by the creditor (Art. 12(4) MCD; Art. 9(2) MCIA 2017).[29]

Ultimately, tying practices have been assessed by the Polish legislator as posing a threat to the effective protection of consumer interests, because they typically hinder the ability to compare offers of various creditors, entail additional costs to the consumer that are difficult to precisely calculate, relate to services that may not correspond to the consumer's needs (misselling), and complicate or exclude the right of withdrawal.[30] Consequently, in the MCIA 2017 it has been decided that tying mortgage credit with an investment product, a private pension product, or in conjunction with a shared-equity credit agreement, mentioned in Art. 12(2)(b)(c) MCD is not permissible. There is also no possibility to offer tying practices upon the creditor demonstrating to its competent authority that the tied products or categories of product offered, on terms and conditions similar to each other, which are not made available separately, result in a clear benefit to the consumers taking due account of the availability and the prices of the relevant products offered in the market (Art. 12(3) MCD).

The MCIA 2017 does allow bundling practices by concisely stating that the creditor may utilize bundling practices when offering mortgage credit (Art. 9(4) MCIA 2017). Unlike in the case of tying, in bundling practices, mortgage credit and the offered, additional services may be acquired separately. In order for this to be clear and understandable, the legislator not only requires that the creditor inform the consumer that mortgage credit is available without any additional services, but also provides the consumer with information about the mortgage credit without it being bundled with other products/services (Art. 9(5) and (6) MCIA 2017). Importantly, the information is required even if the consumer declares not to be interested in obtaining mortgage credit without the bundled service/product. The solutions regarding bundling are not connected with implementing the MCD, but have been adopted by the Polish legislator in order to increase consumer protection, by making bundling practices more transparent, thus allowing the consumer to consciously decide whether bundling is desirable, because of e.g. lower costs, ease of acquisition, facilitated access to services.[31]

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[28] On Art. 12(2)(a) MCD see ECJ 15 Oct. 2020, *Association française des usagers de banque*, C-778/18, EU: C:2020:120.

[29] Nierodka (2018) 52-53.

[30] Rogoń (2015) 169-170.

[31] Czech (2019a) 275-276.

V The Cooling-off and Reflection Periods, the Right of Withdrawal and Early Repayment

In order to obtain mortgage credit, the consumer must submit a credit application to the creditor (Art. 14(1) MCIA 2017), who, on its basis, will assess the consumer's creditworthiness (Arts 21-24 MCIA 2017) and, depending on the outcome, will communicate the decision as to whether mortgage credit will or will not be granted on the 21st day after receiving the application, unless the consumer agrees to receive this information earlier (Art. 14(2) MCIA 2017). A positive decision on granting mortgage credit constitutes, pursuant to Art. 14(4) MCIA 2017, an offer in the understanding of private law and is legally binding for a period of at least 14 days, so the creditor is free to lengthen that period in the interest of the consumer. If the consumer had agreed to receive the credit decision before the lapse of the said 21 days, the 14-day period is extended by the number of days, by which the 21 day period was shortened (Art. 14(6) MCIA 2017).

The creditor's obligation to inform about the credit decision on the 21st day is the cooling-off period aimed at protecting the interest of the consumer, who, on one hand, should not have to wait indefinitely for the decision and, on the other hand, should have sufficient time to compare offers, assess their implications and make an informed decision (Art. 14(6)6 MCD). Interestingly, only Greece and Poland implemented this optional 'cooling-off period'.[32] It should also be noted that although consumers may agree to shorten the 21 day period, the legislator does not allow them to agree to an extension of that period.[33] If the mortgage credit agreement is not concluded, all fees the consumer has paid before the anticipated contract conclusion, e.g. commissions on analysing the credit application and making the credit decision, must be reimbursed (Art. 15 MCIA 2017).

As indicated above, the creditor's offer is binding for 14 days, unless the creditor introduced or the parties agreed on a longer period. During that time the consumer has time to reflect on whether to take the offer and the creditor is prohibited from forcing or otherwise pressuring the consumer to accept the offer in that period (Art. 14(6) MCIA 2017), although the consumer is free to do so at any moment during the reflection period. In case the consumer has not taken time to properly reflect or has, for any reason, decided that taking out mortgage credit was a mistake, the legislator has also provided the right of withdrawal within 14 days of concluding the mortgage credit agreement (Art. 42(1) MCIA 2017). At the time of concluding the mortgage credit agreement, the creditor is obliged to provide the consumer with a template for exercising the right of withdrawal (Art. 43 MCIA 2017). Exercising that right by the consumer is not connected with any costs and the creditor may only claim interest on the loan from the day it was paid to the day it was repaid. The consumer should return

[32] European Commission (2020) 160.
[33] Heropolitańska & Nierodka (2019) 139.

the obtained loan together with interest without undue delay, but no later than 30 days from exercising the right of withdrawal (Art. 44(1) and (2) MCIA 2017).

Taking into account the cooling-off period, the time to reflect and the right of withdrawal it is justified to state that the Polish lawmaker has adopted a higher protection standard than the one following from Art. 14(6) MCD, with the aim of effectively promoting responsible lending and borrowing practices.[34]

The consumer is also afforded the possibility of early repayment of mortgage credit at any time before the expiry of the agreement, in whole or in part and, at the request of the consumer, the creditor is obliged to provide the consumer information on the costs of such repayment (Art. 38(1) and (2) MCIA 2017). As a rule, the creditor cannot charge any fees for the mere fact that the consumer wishes to exercise the right of early repayment. However, as an exception, the legislator allows the creditor to introduce in the mortgage credit contract a clause on compensation for early repayment (Art. 40(1) MCIA 2017). The permissible compensation varies, depending on whether the interest rate is variable or fixed as well as on the time left until the end of the term of the mortgage. In the case of a mortgage credit with a variable interest rate, the creditor may collect compensation only if all or part of the mortgage loan has been repaid within 36 months from the date of concluding the mortgage credit agreement. In such a situation, the compensation referred to in section 2 may not be higher than the amount of interest that would be charged on all or part of the mortgage credit repaid ahead of schedule within a period of one year from the date of actual repayment, nor higher than 3% of the repaid amount of the mortgage credit. If less than one year remains until the end of the term of the mortgage credit agreement with a variable interest rate, the compensation cannot be higher than the interest that would be due for the period remaining until the end of the mortgage credit agreement (Art. 40(2) – (5) MCIA 2017).

In the case of a mortgage loan where a fixed interest rate applies for a given period, the lender may collect compensation during that period. The compensation cannot, however, be higher than the lender's costs directly related to the early repayment (Art. 40(6) MCIA 2017). Unlike mortgage credits with a variable interest rate, in this case there are no statutory restrictions as to the period during which compensation is due and to its amount. The only exception, expressed in Art. 40(7) MCIA 2017, is the requirement that compensation cannot be higher than the lender's costs directly related to the early repayment. This mainly concerns the so-called break costs and technical costs of servicing the early repayment. It should be added that this latter restriction applies, *lege non distinguente*, to both variable and fixed interest rate mortgage credits.[35]

[34] Czech (2019a) 327.
[35] Czech (2019b) 35.

The European Commission has assessed that after the introduction of the MCD, the proportion of consumers whose current mortgage provider offers the option of early repayment has increased in Poland by 8%.[36] Simultaneously it was noted that more than half (57%) respondents to the European Commission's study who had withdrawn from a mortgage credit agreement had difficulties when exercising their right to withdrawal. The countries where most consumers reported difficulties were Poland (79% reported difficulties), followed by Cyprus (77%) and Hungary (73%).[37]

VI The Problematic Foreign Currency Mortgage Loans

Mortgage loans did not gain popularity in the Polish real estate market until after the year 2000, when annual interest rates dropped below two digit numbers. In 2000 they were at the level of 18.89%, while since 2002 that level has not exceeded 8%,[38] attaining in 2006 one of the lowest levels of 4%.[39] The growing attractiveness of mortgage credit was also linked to the availability of foreign currency loans, predominantly mortgage credit in Swiss Francs (CHF),[40] for which the annual interest rate was roughly two times lower than for mortgage credit in the national currency (PLN). Consequently, between the years 2002 and 2008 more than 69% of mortgage credits were granted in the Swiss currency (CHF).[41] In addition, since banks were interested in increasing their mortgage portfolio, they focused on encouraging and offering foreign currency lending. The growing number of foreign currency credit did attract the attention of the NFA, which, through Recommendation S first issued in 2006, attempted to limit, although not entirely prohibit, such lending practices. Among other requirements, the bank was obliged to consider the risk of foreign currency mortgage credit by testing the effects of 30% changes in the value of the CHF. Meanwhile, in less than 10 years from issuing the Recommendation S, the CHF exchange rate almost doubled, resulting in an appreciation of 1 CHF by close to 100%.[42]

This, to a large extent, was caused by the decision of the Swiss Central Bank on 15 January 2015 to end maintaining a fixed exchange rate of the CHF to the EURO. The solution, originally introduced in 2011 to stop the Swiss currency from appreciating, was abandoned mostly due to a drastic depreciation of the EURO. Since the CHF was pegged to that currency, it also depreciated in value, negatively influencing the Swiss economy. Consequently, the CHF exchange rate was freed, placing in plain sight the severity of problems caused by the Polish banks' substantial reliance on foreign currency mortgage credit and exposed the increasing difficulty for mortgage credit

[36] European Commission (2020) 169.
[37] European Commission (2020) 157.
[38] Wąsewicz (2010) 563.
[39] Lissowska & Szufler (2011) 98.
[40] Bień (2011) 21.
[41] Wąsewicz (2010) 564.
[42] Habdas (2017) 387-389; Wiewórowska-Domagalska (2021) 281.

borrowers to pay mortgage loan instalments as well as their inability to exit the credit agreement by a lump-sum payment.[43]

The share of foreign currency mortgage credit loans in the value of residential mortgage credit has been decreasing from 2010 onwards, with 2014 as the breakthrough year, in which the share of mortgage credit loans in domestic and foreign currency was equal.[44] Nevertheless, for existing mortgage credits in foreign currency the problems caused by the appreciation of CHF remain unchanged and are not ones that may be easily disregarded. The Ministry of Justice has released data showing that just in the year 2023, 90,200 applications regarding CHF mortgage credit loans were filed in courts of first instance, which is 36% more than in 2022. It is also estimated that currently 180,000 such cases are pending in Polish courts.[45] Out of the approximately 700,000 mortgage credit loans in CHF, roughly 360,000, about half of the originally granted ones, are still active.[46] Therefore, the scale of the problem is anything but negligible and is likely to expand, due to the judgments of the European Court of Justice (ECJ), specifically in Polish cases, which are favourable to consumer borrowers.

It should also be noted that no effective legal instruments were introduced to battle the systemic problem of foreign currency mortgage credit. The legislator did amend BLA in 2011 by adding section number 3 to Art. 69 BLA and allowing the foreign currency mortgage credit debtor to pay the loan instalments or repay the loan in part or in full directly in that currency.[47] This was a reaction to unfair contract terms specifying how credit installments are converted into foreign currency by the bank. Permitting borrowers to purchase foreign currency without the bank's involvement was seen as a means of limiting banks' problematic currency exchange mechanisms. however it could not alleviate the problem of hardship caused by the continuous appreciation of CHF.

Another attempt to address the foreign currency mortgage credit problem was the enactment of the Act of 9 October 2015[48] on Support for Debtors in a Difficult Financial Situation, who Incurred Residential Credit. The Act introduced the Borrower Support Fund, operated by the National Economy Bank (Bank Gospodarstwa Krajowego, NEB), which initially could provide an interest-free loan for up to 18 months, with financial aid of up to PLN 1,500 per month to physical persons who are in a difficult financial situation and are obliged to pay mortgage credit

[43] Chybiński (2021) 152-153.
[44] Narodowy Bank Polski (2023) 18.
[45] See https://businessinsider.com.pl/poradnik-finansowy/kredyty/ministerstwo-sprawiedliwosci-ma-pomysl-na-kredyty-frankowe/76wxnv3
[46] Szołański (2024), https://www.prawo.pl/biznes/pozwy-frankowiczow-w-2024-roku,524896.html
[47] BLA amendment introduced by the act of 29 July 2011 on the amendment of BLA and other acts, Journal of Statutes 2011, no. 165, item 984.
[48] Journal of Statutes 2015, item 1925.

instalments. The impact of the act was initially severely limited due to demanding criteria that had to be met by applicants.[49] The Act was amended as of 1 January 2020 in order to make the support available to more people. Currently, the loan may be granted for up to 36 months, with financial aid of up to PLN 2,000 per month and there is the possibility of cancelling part of the loan to be repaid. Although eligibility criteria have been expanded,[50] it has been noted that the amount of approved support to borrowers is very small, since it is about 6% of the Borrower Support Fund.[51] According to data provided by the Finance Ministry, as of the end of 2022, since the beginning of the Fund's operation, creditors have registered 9,960 support agreements with NEB for a total amount of 591.4 million PLN. During this time, NEB has paid 59,753 support installments in the total amount of PLN 96.7 million.[52] The Act does provide a solution to those in a difficult financial situation, but it does not resolve the matter of whether and how the existing foreign currency mortgage credit loans should be eliminated. The provided support denotes that banks receive all payments according to the loan agreement, even though it contains unfair contract terms and, in most cases, may be held to be completely invalid.

The implementation of the MCD has, however, finally forced banks, previously not effectively controlled in this respect by the NFA, to not grant foreign currency loans, except when most of the income or assets are held or valued in that currency. Pursuant to Art. 6 MCIA 2017, mortgage credit may be granted only in the currency or indexed to the currency in which the consumer earns most of his/her income or holds the majority of his/her financial resources or other assets valued in the currency of the mortgage credit or the currency to which the mortgage credit is indexed (s. 1). In the case of a foreign currency mortgage credit agreement, the lender, at the request of the consumer, is obliged to change the currency of the mortgage credit agreement to another currency if: 1) the consumer earns most of his/her income in that currency or holds most of the funds or other assets valued in that currency as of the date of the last creditworthiness assessment in relation to this mortgage credit agreement, or 2) this currency is the currency of the Member State in which the consumer was domiciled on the date of conclusion of the mortgage credit agreement or in which he or she is domiciled on the date of submission of the application (s. 2). Finally, the currency conversion referred to in section 2, is performed according to the average exchange rate announced by the National Bank of Poland on the day of submitting the application (s. 3). The above provision severely limits the possibility of granting

[49] Choptiany (2021) 71-73.
[50] For a summary of eligibility criteria see Finance Ministry's information at https://www.gov.pl/web/finanse/fundusz-wsparcia-kredytobiorcow--pomoc-dla-osob-splacajacych-kredyty
[51] Ofiarski (2022) 8-9.
[52] See https://www.gov.pl/web/finanse/kredytobiorcy-ze-wsparciem-na-kwote-prawie-100-mln-zl#:~:text=Fundusz%20Wsparcia%20Kredytobiorców%20%28FWK%29%20to%20pomoc%20dla%20osób%2C,udzielenie%20wsparcia%20na%20łączną%20kwotę%20591%2C4%20mln%20zł

foreign currency mortgage credit agreements to Polish citizens, which, as follows from the discussion below, should be positively assessed.

1 The Legal and Social Context of Foreign Currency Mortgage Credits

As mentioned in the previous section, the appreciation of the Swiss currency in relation to the Polish currency that commenced with the onset of the global financial crisis at the end of 2008 and continues to this day has revealed the precarious situation in which numerous CHF mortgage credit borrowers have found themselves. Leaving aside the predatory (one can rather safely say) lending practices relating to LTV ratios, the lax creditworthiness assessment,[53] or incomplete information about risks[54] that accompanied foreign currency mortgage credit,[55] the public and legal discourse is divided as to which party is to blame for this situation and how to fairly resolve the dispute. On the one hand, it is noted that banks did use unfair contract terms and promoted foreign currency mortgage credit by assuring clients that the currency risk was negligible. On the other, it is also proclaimed that borrowers voluntarily and consciously took the risk of obtaining cheaper credit that backfired, so they choose to play the victim and blame the banks.[56] In particular, some argue that holding the mortgage credit agreement to be invalid due to the impossibility of its performance after the removal of unfair contract terms (relating to the manner of calculating the principal of the loan and the installments that the borrower should pay) must give the bank the right to claim some type of remuneration because the borrower did in fact use the capital provided by the bank. Such use, it is argued, cannot have been gratuitous, because it would lead to a penalisation of the bank unsupported by Directive 93/13 or to the unjustified enrichment of the borrower at the bank's expense.[57]

Admittedly, amid the intense social, political and legal debates, the Polish courts were unprepared to resolve a complex dispute, involving understanding economic concepts inherent to credit activity and various indexing instruments, banking law, but also consumer protection, the latter governed not only by Polish law, but also by EU law. Particularly in the area of consumer protection, '[…] *national courts are expected to constantly act as rebels within their own legal system – rebels against the rules that contradict EU law and rebels against the higher-instance courts that violate EU law*',[58] and this was something that proved extremely difficult for Polish courts. Their default

[53] See Kotlarz (2023) 124 ff. who convincingly argues that the assessment of creditworthiness is no longer a requirement with only public law sanctions, but due to MCD, also one with private law consequences, which are aimed at protecting the consumer; consequently, a proper assessment of creditworthiness will finally gain practical significance.
[54] Choptiany (2021) 68.
[55] See Habdas (2017) 398-400 for a discussion on possible private law consequences of erroneously performed creditworthiness assessments.
[56] Chybiński (2021) 155-157.
[57] Wajda (2021b) 42,45; Wajda (2021a) 25 et seq; Nowakowski (2020) 47-48.
[58] Wiewórowska-Domagalska (2021) 279.

setting, even when striving to restore the balance between the consumer and the professional, is to protect the principle of freedom of contract with its inherent, formally construed assumption of the equality of parties. Meanwhile, consumers are innately a weaker party, particularly vis-à-vis large, professional corporations, and therefore the correct application of national and EU law must give adequate consideration to this characteristic and additionally provide a deterrent to future use of unfair contract terms.[59]

For this reason, Polish courts initially had difficulties to properly apply the notion of unfair contract terms and encountered self-inflicted legal obstacles in adjudicating cases in favour of the consumer. Courts were susceptible to well-prepared, although contrary to EU law, arguments of lawyers representing banks and issued verdicts favouring the banks' interpretation, thus contributing to their lack of motivation in concluding sensible settlements with the borrower.[60] Moreover, there is no legal definition, and therefore no common understanding, of what criteria should be used to differentiate among foreign currency, indexed and denominated foreign currency credit. Furthermore, there is no consensus as to the essence of these differences and whether, even if they exist, they create or should create different economic and legal results.[61] Consequently, contract clauses relating to the conversion from the CHF to the PLN currency (and vice versa) of the principal of the loan and of the ensuing loan installments could be, depending on one's preferences and beliefs, treated as denomination, indexation, or valorisation clauses. In effect, all stakeholders could advertise their own version of the economic and legal consequences of choosing a particular name for the clause. In Polish practice, however, in the vast majority of foreign currency mortgage credits, the principal to be borrowed was expressed in foreign currency, so it was 'denominated' in foreign currency, but that amount was, at the moment of its payment to the borrower, converted into national currency. The borrower paid credit installments in national currency, which was immediately converted into the currency of the credit. In most cases, this meant that banks were also earning money from the so-called 'spread' mechanism, i.e. the difference of the exchange rate when one buys and sells foreign currency, so the borrower was also paying for an additional service, which cannot form a part of a bank credit contract under Art. 69 BLA, to the bank who was acting as a currency vendor.[62]

Nevertheless, more or less subtle differences as to the offered foreign currency mortgage credits do exist, as banking practice varied among banks and also in various time periods. Polish courts were thus faced not only with the necessity of properly understanding the phenomenon of foreign currency credits, but also the foreign currency conversion clauses, as well as with the application of consumer protection law within the context and principles that follow from EU law.

[59] Łętowska (2020) 4-5; Wiewórowska-Domagalska (2021) 291-292.

[60] Łętowska (2020) 5.

[61] Asłanowicz (2023) 153-154; Chybiński (2021) 151-152.

[62] Grebieniow & Osajda (2019) 14-15.

2 The Evolution of Polish Case Law

Disputes regarding foreign currency mortgage credit focused on various contractual clauses pertaining to conversion mechanisms of loan installments, which the plaintiffs argued were unfair and void. Initially, Polish common courts had a problem with offering consumer protection against unfair contract terms, because currency conversion clauses were classified as forming the 'main subject matter of the contract' and were automatically assessed as drafted in plain and intelligible language.[63] There is still no agreement in academic writings as to whether the Polish Supreme Court has ultimately adopted a restrictive interpretation and settled on treating various currency conversion clauses as outside the 'main subject matter of the contract',[64] or whether the opposite is true, and such clauses do constitute the main object of the contact.[65]

If the former position is accepted, the disputed contract terms may be analysed in the context of their unfairness. If the latter is true and they were not individually negotiated, they may not be regarded as unfair, unless they were drafted in language that does not meet the criteria of plainness and intelligibility. Since typically it is rather simple to prove that currency conversion clauses regarding either the principal or the installments had not been individually negotiated, the focus is placed on the requirement of plain and intelligible language. To this end the ECJ case law clarifies that in the case of loan agreements, financial institutions must to provide borrowers with sufficient information that will enable them not only to take notice of the possibility of the exchange rates fluctuating, but also to comprehend the economic consequences on the borrrower's financial obligations of utilising a currency conversion clause.[66] In particular, the ECJ explained that:

> '[…] a contractual term must be drafted in plain intelligible language is to be understood as requiring also that the contract should set out transparently the specific functioning of the mechanism to which the relevant term relates and the relationship between that mechanism and that provided for by other contractual terms, so that that consumer is in a position to evaluate, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it'.[67]

In this light, the Polish courts' frequent, indiscriminate assumption that the threshold of plain and intelligible language if fulfilled by a simple statement informing of the

[63] Supreme Court judgments of: 19 March 2015, IV CSK 362/14, LEX no. 1663827; 4 April 2019, III CSK 159/17, LEX no. 2642144; Łętowska (2020) 5.
[64] See Grebieniow & Osajda (2019) 19-23 and their compilation of Polish Supreme Court judgments.
[65] See Asłanowicz (2023) 164-165, and her compilation of Polish Supreme Court and ECJ judgments.
[66] E.g. ECJ 30 April 2014, *Kásler and Káslerné Rábai*, C-26/13, EU:C:2014:282, para. 75; ECJ 23 April 2015, *Van Hove*, C-96/14, EU:C:2015:262, para. 50.
[67] ECJ 20 September 2017, *Ruxandra Paula Andriciuc and Others v Banca Românească SA*, C-186/16, EU:C:2017:703, para. 45.

existence of a foreign currency conversion mechanism and of fluctuations in currency values, cannot be accepted.[68]

Having surmounted the challenges of finding a legal basis for classifying the currency conversion clauses as unfair, usually on the grounds of their vagueness, lack of objective conversion criteria, and banks' unilateral entitlement to manipulate the conversion rates, Polish courts encountered a further challenge in deciding on the consequences of striking down the mentioned clauses. The initial solution was holding that the whole contract collapses, when the unfair contract term is removed, because without the conversion mechanism there is no possibility of calculating the borrower's debt and installments and there is no basis to transform the contract into a domestic currency one, with the interest rate calculated according to LIBOR (London Interbank Offered Rate). A second solution was holding the opposite, namely that the credit is in fact in domestic currency but the applicable interest rate remains being determined with reference to the LIBOR. The third option present in case law was refusing to entirely invalidate the conversion clause in order to maintain the parties' alleged common intention to conclude a contract in foreign currency. In effect, the courts attempted to substitute the unfair conversion clause with one that utilised the average CHF value reported by the National Bank of Poland or prevalent in the market. Lastly, in some cases the courts would conclude that the borrower is not a consumer, if the residential flat was bought with the intention of renting it out, or that the conversion clauses were not in fact vague to the point of holding them to be unfair.[69]

This case law lottery, although slowly moving in the direction of offering consumer protection to foreign currency mortgage credit borrowers, could not, in a reasonable timespan, produce a predictable legal situation for the consumer. The problem is currently being slowly overcome as a result of ECJ's doctrine regarding cases that Polish courts eagerly referred to the European court, even though they could have relied on holdings already delivered in similar cases, usually involving other, former Eastern Bloc countries, such as Croatia, Czechia, Hungary, Slovenia, or Romania.[70] A major breakthrough, which exposed the considerable disparity between the approach to consumer protection of Polish courts and the ECJ, was the latter's judgment of 3 October 2019 in the K. Dziubak and J. Dziubak v. Raiffeisen Bank International AG case (C-260/18),[71] issued as a result of reference for a preliminary ruling.

The Dziubaks had obtained PLN 400,000 as borrowed principal and had repaid PLN 240,000 under a foreign currency mortgage credit agreement. The European court held that Art. 6(1) of Directive 93/13/EEC does not preclude a national court, having

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[68] Sieradzka (2020) 213.

[69] Wiewórowska-Domagalska (2021) 294-295.

[70] Jabłoński & Koźmiński (2018) 17-19; Western European countries also experienced problems with currency loans, e.g. Austria, Greece, Portugal, and Spain.

[71] ECJ 10 October 2019, *Dziubak*, C-260/18, EU:C:2019:819.

found that certain terms of a credit agreement indexed to foreign currency and with an interest rate directly linked to the interbank rate of the foreign currency, from accepting, in accordance with domestic law, that the contract cannot be upheld without the unfair contract terms on the ground that their removal would result in changing the essence of the main subject matter of the contract. Consequently, consumers did not have to settle only for demanding that the credit agreement be transformed into a domestic currency loan with a LIBOR-based interest rate, but could request the annulment of the entire contract. Importantly, the court held that unfair contract terms cannot be upheld without the consumer's consent, even if their removal leads to the collapse of the agreement and may potentially be more onerous for the consumer. Additionally, it was stated that EU law does not allow supplementing the contract, after the removal of an unfair term and in an attempt to maintain its validity, with national provisions of a general nature, referring to principles of equity or established customs, which do not constitute supplementary provisions or provisions applicable in case the parties agree thereto.

As a result, the Polish court, according to the demand of the plaintiffs, invalidated the entire contract, despite the bank's argument that allowing for the contract to collapse will have more serious consequences for the plaintiffs than upholding it without the unfair contract terms and filling the resulting gap with the WIBOR (Warsaw Interbank Offered Rate) linked interest rate or with the average exchange rate as announced by the Polish National Bank.[72] The court noted that the bank's suggestions are in clear opposition to the judgment which had just been handed down by the ECJ. The bank, however, in one of the documents submitted to court after the ECJ judgment, found it imperative to inform the borrowers that pressing for the annulment of the contract would result in the bank filing a separate lawsuit, demanding PLN 477,000 from them for use of the principal without a contractual basis for 11 years and an additional PLN 321,000 as interest on due remuneration for non-contractual use of that amount.[73] Thus a battle had been won, but the war waged on, with the front line moved to the issue of whether the bank may demand some kind of compensation or remuneration for the time the principal was used by the borrowers.

3 Winning the War and Not Just the Battle

The aftermath of the Dziubak case exposed the banks' mounting problem regarding the fate of a few hundred thousand, still active, foreign currency mortgage credit agreements, but also put the consumers in a precarious position, due to the threat of exaggerated claims directed against them on grounds connected with unjustified enrichment, non-contractual use of capital or valorisation of capital to be returned to

[72] For more details see Asłanowicz (2023) 178-184.

[73] Ojczyk (2020) https://www.prawo.pl/biznes/sprawa-panstwa-dziubakow-frankowicze-po-wyroku-tsue,496972.html

the bank by the borrower. Bering in mind how difficult it was for Polish courts to embrace effective consumer protection in foreign currency mortgage credit cases, the risk was considerable. Little solace came from the realisation that allowing banks to claim any type of remuneration after the collapse of a contract due to unfair contract terms that the bank, a professional on the market and an institution of public trust,[74] itself formulated and included in the agreement, would mean allowing the perpetrator to benefit from their illegal activity and thus could surely not be seriously considered by the courts. The borrowers' apprehension was, however, justified by the fact that Polish courts, as if obstinately, persisted in finding numerous matters that needed to be clarified by the ECJ. They continued to formulate preliminary referrals phrased in a manner exhibiting an affinity to limiting the control of contractual clauses falling under Art. 4(2) of Directive 93/13/EEC in terms of their unfairness or suggesting that consumer protection is unfounded because borrowers themselves were not sufficiently vigilant when concluding the credit agreement.[75]

In particular, the Polish Supreme Court judgment of 7 May 2021[76] raised eyebrows, because the court introduced a differentiation between the so-called suspended ineffectiveness and permanent ineffectiveness (invalidity) of the foreign currency mortgage credit agreement which contains an unfair currency exchange clause. According to the court, suspended ineffectiveness lasted until the consumer, duly informed about the consequences of the invalidity of the loan agreement, submitted a declaration consenting or refusing to consent for an unfair contract term to remain in force. The Supreme Court held that until such a formal declaration is made by the borrower, the bank cannot pursue a claim for the return of the loan principal, and thus the three-year limitation period for this claim does not begin to run. This also had serious consequences relating to the moment from which the consumer could claim interest on the amount the bank was to repay the client if the contract were to be held invalid. If suspended ineffectiveness was applied, the interest would accumulate for the consumer not from the moment of filing the claim against the bank, but from the moment of making an additional declaration by the consumer during the proceedings. Unfortunately, common courts followed this new interpretation and began to adjudicate these matters to the detriment of the borrowers.[77]

It remains a mystery (or maybe it doesn't?), why the Polish Supreme Court had difficulties in correctly interpreting Art. 6(1) of Directive 93/13/EEC and applying the extensive ECJ case law relating to that provision. In effect, as a result of two preliminary referrals filed by a District Court in Warsaw and a Regional Court in

[74] Zapadka (2022) 726; Constitutional Tribunal judgment of 29 Jan. 2002, K 19/01, LEX nr 52918; also see Czarnota (2014) 153 ff.; Chybiński (2021) 156-157.
[75] Wiewórowska-Domagalska (2021) 296.
[76] III CZP 6/21, LEX No 3170921.
[77] Konieczny (2023), https://www.prawo.pl/biznes/grudniowy-hat-trick-na-korzysc-kredytobiorcow-frankowych,524462.html

Warsaw, the ECJ had to reiterate that the possibility open to a consumer to object to the application of Directive 93/13/EEC cannot be understood as imposing on him or her, in order to assert the rights deriving from said directive, the positive obligation to rely on the provisions of the directive by means of a formal declaration lodged before that court. The two preliminary rulings issued by ECJ as a result of the mentioned referrals were judgments of: 7 December 2023 (C-140/22; mBank)[78] and 14 December 2023 (C-28/22; Getin Noble Bank).[79] It also follows from these rulings that foreign currency mortgage credit borrowers, may demand interest on money owed them by the bank in case the latter loses the dispute regarding the validity of the foreign currency mortgage credit contract, for the entire duration of the dispute, starting from the pre-trial payment request addressed to the bank or, at the latest, from the date the court delivered a copy of the lawsuit to the bank.[80] It should be noted that both preliminary rulings were issued by the same bench of 3 judges, having the same Advocate General, who did not issue written opinions. This indicates that the ECJ considered the cases to be straightforward and not causing serious doubts, which further illuminates the unexplained difficulties Polish courts are experiencing in applying well-known provisions on consumer protection, the interpretation of which has been extensively covered by the ECJ.[81]

Another recent victory for borrowers questioning the validity of their foreign currency mortgage credit agreements was the ECJ judgment of 15 June 2023 (C-520/21; A. Szcześniak v. Bank M.),[82] where the Court held that under Directive 93/13/EEC banks cannot claim remuneration for the use of the loan principal without a contractual basis, as this would deprive the Directive 93/13 of its effectiveness and be inconsistent with its aim of being a deterrent to unfair contract terms. The banks reacted by modifying their claims and seeking an indexation of loan principal paid out under contracts that have been held to be invalid. That avenue, however, has also been rejected by the ECJ in the order of 11 Dec. 2023 (C-765/22; Bank Millennium),[83] where it was stipulated that if a mortgage loan agreement had been concluded with a consumer by a banking institution and was subsequently held to be invalid in its entirety due to its unfair terms, courts of the Member State cannot employ judicial interpretation of the law, the outcome of which would be awarding the bank the right to demand from the consumer the return of amounts other than the capital paid for the performance of this contract and statutory interest for delay from the moment of requesting payment.[84] Despite these judgments, banks, which admittedly face somber consequences of employing unfair contract terms and having foreign mortgage credits

[78] ECJ 7 December 2023, *mBank,* C-140/22, EU:C:2023:965.

[79] ECJ 14 December 2023, *Getin Noble Bank*, C-28/22, EU:C:2023:992.

[80] Gontarski & Parchimowicz-Gontarska (2023) 97-98.

[81] Gontarski & Parchimowicz-Gontarska (2023) 84, 90.

[82] ECJ 15 June 2023, *Arkadiusz Szcześniak v Bank M. SA*, C-520/21, EU:C:2023:478, para. 86.

[83] ECJ 11 December 2023, *Bank Millennium S.A. v ES and AS*, C-756/22, EU:C:2023:978.

[84] See Michałuszko (2023), 40 ff. for a convincing legal explanation of why banks cannot request remuneration on any grounds in the case of contract invalidity.

contracts invalidated, are slow to offer consumers satisfactory settlements, which even at the end of 2023 have not gained in popularity.[85] It remains to be seen if after the mentioned decisions of the ECJ the situation changes.

4 The Original Sin

Foreign currency mortgage credit agreements have caused numerous disputes and complex litigation not only before national courts of several EU Member States, but also before the ECJ. It is, however, striking that a loan contract, which is a rather simple agreement consisting of the creditor lending principal for a period of time and the borrower returning that principal with interest, could be the source of such complicated social and legal consequences, particularly when the loan is made by a banking institution and one is dealing with mortgage credit. The plethora of case law and academic writing on the topic in Poland alone is astounding, which should suggest that the issue in hand is not in fact related to a loan contract, but rather to some kind of financial instrument. This view was rejected by ECJ in a judgment of 3 December 2015[86] regarding a foreign currency denominated consumer credit agreement concluded by a Hungarian citizen and a bank. At the time the loan was granted, the bank calculated the equivalent amount in foreign currency of the amount that it was to advance in Hungarian forints to the borrower, in accordance with the exchange rate applicable on a date which had been previously determined. Next, the bank purchased from the client that currency, which (had been registered as) chargeable to him, using the actual exchange rate for purchases of foreign currency that was applicable at the time of the advance of the loan (transaction at the prevailing exchange rate) and paid the equivalent amount in Hungarian forints to the client. Later, the bank sold to the client the registered currency in exchange for forints, using the actual exchange rate for sales of foreign currency that was applicable at the time of the repayment of the loan (transaction at the future exchange rate applicable at the time of repayment), in order that the client could meet, in foreign currency, his repayment obligation, which was registered in foreign currency.

The above scenario does not resemble a loan contract, where the borrower returns the original amount of principal actually received plus the interest agreed upon, which serves as remuneration for using someone else's money for a specified period of time. Nevertheless, the ECJ refused to consider this mechanism as being characteristic of a financial instrument, but rather decided that the virtual conversions of currency were nothing more than a technical element of the loan and they did not amount to investments or ancillary services (§§ 56-67). Meanwhile, it seems that the opposite is true and various disputes regarding foreign currency credit or mortgage agreements neglect to consider their actual, economic characteristics, which are

[85] Augustynowicz (2023), https://chf24.pl/nowy-rzad-a-frankowicze-i-kredyty-we-frankach-co-dalej-w-2024-roku/

[86] ECJ 3 December 2015, *Banif Plus Bank Zrt. v Márton Lantos and Mártonné Lantos*, C-312/14, EU:C:2015:794.

connected with the sale of an option. One is in fact dealing with a bet on the value of currency, rather than with a loan agreement. For this reason, such agreements carry a risk unprecedented in actual loan contracts, where the only risk is associated with the interest rate on the principal. This is also why complex discussion as to the differences between denominated, indexed or valorised foreign currency contracts are beside the point, because the variations are only formal, not substantive,[87] and because the problem is not in the name and technical conversions of currencies or whether they are clear and fair, but in the fact that what the borrower obtained was not a loan or not only a loan.

To better illustrate the point, it should be noted that the essence of a loan, particularly a bank loan, granted by a professional, public trust institution, is uncontroversial. The creditor advances money to the borrower for a specified period of time and the borrower repays that principal, together with interest.[88] It comes as no surprise that the borrower must return exactly the same amount of money as was received it. In addition, the borrower pays interest on being able to use someone else's money for a period of time. Meanwhile, in foreign currency credit agreements, the 'loan', through various foreign currency clauses, is structured in such a manner that the borrower is asked to repay more (or if the exchange rate works in their favour – less) than actually obtained as principal. This cannot be reconciled with the essence of a loan.

In Poland, it is safe to say, there were no mortgage credit contracts in which the bank actually advanced foreign currency to the borrower.[89] What the borrower obtained as principal, was a specific sum of money in domestic currency (PLN), which is unsurprising, because neither the bank nor the borrower had any economic need to acquire foreign currency.[90] Nevertheless, instead of returning that specific sum of money (i.e. that amount of principal), the borrower returns more (or less, if foreign currency loses value in relation to domestic currency), than the sum actually obtained from the creditor. Apart from that, the borrower pays interest, but once again, the installment does not depend on the interest rate, but on the interest rate and the currency exchange rate. Classifying such an agreement as a bank loan contract is unacceptable, just like no one would agree that at the end of a lease the tenant must return a three bedroom apartment, or a one bedroom apartment, depending on whether the indexation incorporated into the rent clause works in his/her favour or not.[91]

Unsurprisingly, these imposter loans carry a significant risk, disproportionately borne by the debtor, who resembles an involuntary investor or gambler, rather than a borrower under a loan agreement. The debtor is exposed to an unlimited currency

[87] Asłanowicz (2023) 155; Choptiany (2021) 67.
[88] Michałuszko (2023) 41.
[89] Grebieniow & Osajda (2019) 15.
[90] Asłanowicz (2023) 154.
[91] Tracz (2022) 147-148.

risk, which is not assigned symmetrically between parties to the contract. Even if the foreign currency value drops to zero, the bank will not lose more than the principal paid out. Instead, the borrower has no limits as to the money owed, because the value of foreign currency may grow indefinitely.[92] Increases in the value of foreign currency will not only cause monthly instalments to increase, but will also cause the value of the loan, i.e. the 'principal' to be repaid to increase beyond what the bank actually advanced to the borrower. This also excludes the possibility to exit the loan by making a balloon payment, because despite repaying the loan for many years, the amount still remaining to be paid (due to the constant recalculation of the foreign currency value) is often larger than the original sum paid out by the bank. In addition, this often causes the value of the loan to exceed the value of the mortgaged immovable and the borrower will still be in debt even after the latter is seized, the situation being completely dire in the case of loans with an LTV ratio of 100% or more.[93] To add insult to injury, the banks, being the best informed professional lending institutions, assumed the currency risk at a maximum of 30%, while the increase of CHF value in relation to PLN between 2008 and 2022 reached 115%. Therefore, it is not viable under any circumstances to hold that had the consumer acted prudently, the currency risk would have been properly taken into account by the borrower when deciding on the conclusion of the credit agreement.[94]

The above arguments allow one to conclude that, contrary to popular opinion, the concluded foreign currency contracts are not bank loan contracts, but some kind of speculative, financial instruments,[95] additionally connected with the bank's currency exchange service at imposed and unpredictable rates.[96] The borrower's strange obligation to give back more principal than was advanced, the unprecedented risk connected with performing the contract, the dire consequences of increases in currency values, the virtual foreign currency exchange with no economic use for the parties, and the bank's currency exchange (a non-gratuitous service embedded in the agreement), all indicate that consumers, despite being assured to the contrary, did not in fact conclude bank loan contracts, but some kind of financial option agreements. If it looks like a duck, walks like a duck and quacks like a duck…

Accepting this reality would have simplified the legal assessment of the situation, since misrepresentation, circumvention of law, and violation of the essence of a bank loan contract would have provided good legal grounds to successfully argue the invalidity of the contract and resolve the dispute more quickly. This may have also more effectively deterred banks from offering speculative contracts to consumers, as it would have been simpler for the courts to see the violation of the law.

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[92] Czabański (2016) 69; Jastrzębski (2015) 6.
[93] Łętowska (2020) 5; Wiewórowska-Domagalska (2021) 282.
[94] Tracz (2022) 131.
[95] Choptiany (2021) 77.
[96] Tracz (2022) 156.

VII Conclusions

The implementation of the MCD has improved the standard of consumer protection in the mortgage credit market. It has also alerted the Polish legislator to the unsatisfactory level of consumer protection and provided motivation to consider the baseline situation and thus introduced necessary solutions that are more protective than those laid down by the MCD. Notably, before the implementation of the MCD, credit intermediaries were not under the supervision of the NFA and there were no requirements regarding knowledge, training or skills of persons performing intermediary and advisory activities in the mortgage credit market, nor were these persons obliged to have civil liability insurance. The implementation of the MCD has changed this situation by including mortgage credit intermediaries in the realm of NFA supervision, requiring their proper education as well as civil liability insurance. The Polish legislator has prohibited, in accordance with the possibility indicated in Art. 22 (4) MCD, using the term 'advice', 'advisor', or similar terms when the advisory services are being provided to consumers by creditors, tied credit intermediaries or appointed representatives of tied credit intermediaries. Furthermore, the use of the terms 'independent advice' or 'independent advisor' is only available to credit intermediaries or their appointed representatives who are not tied and do not receive remuneration from the creditor, whether in money or in any other form of financial benefits. These developments in legislation regarding mortgage credit intermediaries are nothing short of revolutionary on the Polish market.

In should also be noted that implementing the MCD has had a visible impact on improving the consumers' opportunities of making a well-considered and informed decision, due to introducing the obligation of creditors to provide more comprehensive and understandable pre-contractual information. Cooling-off and reflection periods, the right of withdrawal and early repayment have also been regulated to support the consumer in avoiding rash decision making. Prior to the implementation of the MCD, Polish legislation did not include rules on bundling and tying practices. The latter has been assessed by the Polish legislator as posing a threat to the effective protection of consumer interests, and therefore the use of tying practices has been strictly limited.

Unfortunately, the implementation of the MCD could not solve the problem of foreign currency mortgage credit. Although up to now no effective legal instruments have been introduced to battle the systemic problem of such loans, the implementation of the MCD did at least force banks, previously not effectively controlled in this respect by the NFA, to abandon granting foreign currency loans, except when most of the income or the majority of the assets are held or valued in that currency. Consequently, such loans are basically no longer available in Poland. Nevertheless, out of the approximately 700,000 mortgage credit loans in CHF, roughly 360,000 are still active. Currently 180,000 cases regarding the invalidation of foreign currency mortgage credits are pending in Polish courts.

Disappointingly, Polish courts had, and to some extent still continue to have, significant difficulties in providing effective consumer protection at the level required by EU standards. Courts are susceptible to well-prepared, although contrary to EU law, arguments of lawyers representing banks and fall into the trap of creating unnecessary legal doubts and problems. The ECJ's doctrine has finally helped Polish courts to overcome the challenges of finding a legal basis for classifying the currency conversion clauses as unfair, usually on the grounds of their vagueness, lack of objective conversion criteria, and banks' unilateral entitlement to manipulate the conversion rates. However, a further challenge emerged as courts were unsure as to what the consequences of striking down the mentioned clauses were. In effect, different solutions followed from judgments.

This case-law lottery is currently being slowly overcome as a result of ECJ's interpretation regarding cases that Polish courts eagerly referred to the European court. A major breakthrough, which exposed the considerable disparity between the approach to consumer protection of Polish courts and the ECJ, was the latter's judgment the 2019 *Dziubak case*. The European court held that Art. 6(1) of Directive 93/13/EEC does not preclude a national court from concluding that a whole contract may collapse as a result of finding unfair contract terms in the agreement. An important battle had thus been won by the consumers, but the war waged on, with the front line moved to the issue of whether the bank may demand some kind of compensation or remuneration for the time capital was used by the borrowers. Again, were it not for the ECJ's rulings, the consumer's position would have been extremely precarious, as Polish courts had an affinity to the banks' arguments that regardless of the circumstances, the use of the principal by the consumer could not have been free. It took several judgments of the ECJ to finally convince Polish courts that no remuneration, under no legal grounds or doctrine, may be sought by banks in new litigation.

The application of consumer protection laws has so far proven to be an exhausting, long way round to arrive at a solution compliant with national and European laws in force. This has not been caused solely by the fact that the application of European and domestic provisions on consumer protection has proven to be a challenge for Polish courts. The original sin, committed by both European and national courts, seems to lie in the fact that distorting a legal concept and treating a speculative, financial agreement as a bank loan contract, is never efficient, its results are usually not completely predictable, and may sometimes obscure the future, proper use and understanding of legal principles. In the short term, although after almost a decade of litigation, maybe some kind of a solution to foreign currency bank loan contracts has been achieved. In the long run, however, the willingness to deny or overlook the fact that a duck is a duck will backfire and courts will find themselves back in square one when the next round of creative financial instruments targeting consumers comes along.

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CHAPTER 11
Mortgage Credit in Portugal
Six Years After the Transposition of Directive 2014/17/EU

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I General Overview of the Transposition of Directive 2014/17/EU in Portugal

Although the deadline for the transposition of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property (MCD) expired on 21 March 2016, the MCD was only transposed in Portugal after well over a year of delay, partly by Decree Law (DL) 74-A/2017, 23 June, and partly by DL 81-C/2017, 7 July.

In the transposition of the MCD, the Portuguese legislator has opted to separate the rules governing the activity of credit intermediaries and the provision of consultancy services in DL 81-C/2017, while transposing all the remaining provisions of the MCD in DL 74-A/2017, which, therefore, contains most of the legal framework.[1]

Both DL 74-A/2017 and DL 81-C/2017 came into force on January 1, 2018, except for the final part of Art. 12(3)(e) DL 74-A/2017, which came into force on July 1, 2018. Since coming into force, DL 74-A/2017 has already been amended five times: by DL 32/2018, 18 July; DL 13/2019, 12 February; DL 57/2020, 28 August; DL 20-B/2023, 22 March; and L 24/2023, 29 May. DL 81-C/2017, for its part, was amended only once by DL 122/2018, 28 December.

Both DL 74-A/2017 and DL 81-C/2017 are developed by Portarias (Ordinances) 385-D/2017, 29 December and 385-E/2017, 29 December. DL 74-A/2017 is also developed by Portaria 385-C/2017, 29 December, and DL 81-C/2017 is also developed by Portaria 385-B/2017, 29 December.

[1] For a detailed analysis of the Portuguese legal regime resulting from the transposition of the Mortgage Credit Directive, Duarte (2018); Vasconcelos (2021) 203-215; Passinhas (2018) 415-487.

With regard to the Portuguese legal regime on mortgage credit, it is also essential to mention the decisive role of the rules approved by the Bank of Portugal in its exercise of supervisory powers,[2] namely: i) Aviso do Banco de Portugal 4/2017, 22 September, that establishes the procedures and criteria to be observed by the financial institutions when assessing the consumer's creditworthiness; ii) Aviso do Banco de Portugal 5/2017, 22 September, that develops the provisions of Art. 5 DL 74-A/2017, establishing the rules to be observed by creditors in defining the remuneration policies of employees involved in the preparation, commercialisation and granting of credit agreement; the provisions of Art. 14 DL 74-A/2017, defining the rules to be observed by creditors and, where applicable, credit intermediaries, within the scope of the duty to assist the consumer; the provisions of Art. 22 DL 74-A/2017, establishing the information duties applicable to creditors for the duration of the credit agreement and the information duties applicable to creditors when negotiating and concluding credit agreements regulated by DL 74-A/2017; iii) Aviso do Banco de Portugal 6/2017, 06 October, that develops various provisions of the legal framework approved by DL 81-C/2017, relating to the authorisation process for credit intermediaries, the registration of credit intermediaries with the Bank of Portugal and the remuneration policies of entities that carry out the activity of credit intermediary or provide consultancy services concerning credit agreements.

It is safe to say that the transposition of the MCD did not entail any disruptive changes in the Portuguese legal regime on housing credit, which already offered a higher level of protection than that imposed by the Directive on many points. In the wording of Rui Pinto Duarte,[3] DL 74-A/2017 introduced mainly details in the Portuguese pre-existing negotiating praxis, given that most of the rules are very similar to the previous legal and regulatory regime.

In fact, one of the most important contributions of the transposition of the MCD into the national legal system was the aggregation and systematisation of a significant part of the previously dispersed legislation, making the legal framework more accessible and comprehensible to the consumer-borrower.[4]

As was highlighted in a previous work on this topic,[5] before the transposition of the MCD, the legal regime on housing credit in Portugal resulted from the coordination

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[2] On the importance of the regulatory powers of the Bank of Portugal, Amorim (2015) 323-338 and Guimarães & Redinha (2007) 707-723.

[3] See Duarte (2018) 86.

[4] We mentioned this expected benefit before the transposition of the Directive in Costa (2017) 430.

[5] Costa (2017) 430.

between several statutes, mainly DL 349/98, 11 December, containing the Legal Regime regulating Housing Credit Approval, and DL 51/2007, 7 March, containing the Legal Regime regulating Commercial Practices in Mortgage Credit Contracts. When it entered into force, DL 74-A/2017 aggregately replaced and subsequently revoked DL 51/2007, 7 March (in its most recent version); DL 240/2006, 22 December; DL 171/2008, 26 August; DL 192/2009, 17 August, and DL 226/2012, 18 October.

It also revoked articles 5, 6, 7-A, 7-B, 18 to 22, 23-B, 24, 28-A and 30-A of DL 349/98, 11 November. Still, the Portuguese legislator has decided to maintain the rest of the previous legal regime on Housing Credit Approval in force. This means that DL 349/98 remains in force today, although with a much more restricted and, to a certain extent, residual area of application.[6]

Both the scope of application of DL 74-A/2017 and DL 81-C/2017 exceed the scope of application of Directive 2014/17/EU.

Regarding DL 74-A/2017, in addition to consumer credit for the acquisition or construction of residential property and consumer credit for the acquisition or maintenance of property rights over land or buildings for non-housing purposes, it also covers consumer credit agreements, for purposes not related to immovable property, provided that the credit is 'secured by a mortgage or other equivalent warranty commonly used on immovable property, or secured by a right relating to immovable property' [Art. 2(1)(c) DL 74-A/2017]. With some exceptions, it also applies to financial leasing of residential property (Art. 2(2) DL 74-A/2017).[7]

As highlighted by Sandra Passinhas,[8] the Portuguese legislator has also chosen to include in the scope of application of DL 74-A/2017 credit agreements for the acquisition (or financial leasing) of residential property to rent, as long as the borrower acts outside the scope of its professional activity, thus not making use of the opt-out option provided for in Art. 3(3)(b) MCD.

DL 74-A/2017 is not applicable to: a) credit agreements whose purpose is to finance construction works on previously existing immovables and which are not secured by a mortgage or other right over immovable property; b) equity release credit

[6] For a more detailed analysis of the scope of application of DL 349/98 today, see Vasconcelos (2021) 203-204.

[7] On the scope of application of DL 74-A/2017, see, for all, Duarte (2018) 9 and 19 ff.; Passinhas (2018) 432-434; Guimarães (2022) 208-209.

[8] Passinhas (2018) 433.

agreements in which the lender makes a single payment, periodic payments or otherwise disburses the credit as consideration for an amount resulting from the future sale of immovable property or the transfer of a right over immovable property and does not demand repayment of the credit until one or more specific events in the consumer's life have occurred unless the consumer's failure to perform the contractual obligations allows the creditor to terminate the credit agreement; c) credit agreements in which the credit is granted by an employer to its employees as a benefit associated with their employment, without interest or with an annual percentage rate of charge (APRC) lower than those applied on the market, and which is not offered to the general public; d) credit agreements in which the credit is granted without interest and other charges, with the exception of those covering costs directly related to guaranteeing the credit; e) credit agreements that result from a transaction in court or before another public authority; f) credit agreements which merely provide for the deferred payment of a pre-existing debt, without any charges, and which are not covered by Article 2(1)(a) or (c) of DL 74-A/2017.

Even though the Portuguese legal literature still does not pay much attention to equity release products, the dominant opinion is that the exclusion of these products from the scope of the MCD and, concomitantly, from the scope of application of DL 74-A/2017, is appropriate, given the specific characteristics of these contracts, which, for example, as mentioned in Recital 16 of the MCD, make the creditworthiness assessment of the consumer irrelevant and require a substantially different content of pre-contractual information.[9]

Regarding the contractual parties, as mentioned above, DL 74-A/2017, following the solutions adopted by the MCD, requires that the borrower be a consumer in the sense of Art. 4(1)(d) of the said DL, according to which consumers are individuals who act with purposes outside the scope of their commercial or professional activity. On the other hand, the lender may be any entity authorised to carry out, professionally, the activity of credit granting in Portugal under the terms of the Legal Regime regulating Credit Institutions and Financial Corporations (RGICSF), approved by DL 298/92, 31 December, and the other laws and regulations governing this activity [Art. 4(1)(o) DL 74-A/2017]. The referral to the general regime that regulates credit institutions and financial corporations introduces flexibility for the potential extension of the mortgage credit regulations to new stakeholders operating in this activity, such as crowdlending platforms.

The scope of application of DL 81-C/2017 is set in its Art1, according to which this statute establishes the legal regime that defines the requirements for access to and

[9] Duarte (2018) 22, footnote 24; Passinhas (2018) 434, footnote 27.

exercise of the activity of credit intermediary and the provision of consultancy services concerning credit agreements, which is approved in Annex I to this Decree-Law, forming an integral part thereof.

Art. 2 of the said Annex states that these rules apply to both natural and legal persons who act as credit intermediaries and provide consultancy services on credit agreements concluded with consumers in Portugal, with the exceptions of: a) the provision of credit intermediation or consultancy services on an occasional basis as part of a professional activity governed by legal, or deontological rules that do not exclude the practice of such acts or the provision of such services; b) the provision of consultancy services for non-commercial purposes in the context of public or voluntary debt management consultancy services; c) the provision of credit intermediation or consultancy services about credit agreements for carrying out operations on financial instruments in which the credit grantor intervenes, as provided for in Article 291 of the Portuguese Securities Code. It is therefore clear that the scope of application of DL 81-C/2017 includes, but is not limited to, credit agreements related to residential immovable property.

II Positive Impacts Deriving from the Transposition of Directive 2014/17/EU in Portugal

As previously mentioned, the transposition of the MCD in Portugal did not entail any disruptive evolution in the Portuguese legal regime. In fact, most of the topics covered by the MCD were already regulated by the national laws, and in various aspects, the pre-existing regulation was more protective than the solutions resulting from the Directive.[10]

Nevertheless, the transposition of the MCD made some relevant contributions to the Portuguese legal regime regarding mortgage credit.

First, it led to the aggregation and systematisation of the legal framework, the relevance of which should not be underestimated since it has made the legal regime much more accessible and comprehensible to all the parties involved and to legal operators.

The transposition of the Directive has also led to some substantial alterations to the previous legal regime, with the introduction of new requirements and safeguards that positively affect the transparency and governance of the credit system and the protection of consumers.

[10] For more details on this topic, see Costa (2017) 424 ff.

Amongst these new legal developments are the above-mentioned regulation of credit intermediation activities and the provision of consultancy services, transposed by DL 81-C/2017, and the introduction of new rules on the remuneration policies of the staff involved in drawing up, marketing and granting of credit agreements, as well as the legal imposition of knowledge and competence requirements for these employees (Arts 5 and 6 DL 74-A/2017). These rules had no equivalent in the Portuguese legal system before the transposition of the Directive and are of indisputable importance to the transparency and proper governance of the sector.

Regarding the rights and duties of the contractual parties, the following innovative solutions may be highlighted.

The first is enshrined in Art. 13(5) DL 74-A/2017, which sets a mandatory minimum reflection period of seven days, during which the consumer is prevented from accepting the contractual offer. This rule results from the transposition of Art. 14(6) MCD, which allowed the Member States to choose between a mandatory reflection period or a right of withdrawal. The Portuguese legislator chose the first option.

According to Art. 13(4) DL 74-A/2017, the seven-day minimum reflection period coincides with the first seven days of a 30-day minimum period during which the creditor remains bound by the contractual offer made to the borrower.

Before the transposition of the MCD, the Portuguese legislation did not foresee either a legally binding minimum period of irrevocability of the contractual offer or a minimum reflection period (or an equivalent right of withdrawal) by the borrower. Such solutions play a relevant role in reinforcing consumer protection by promoting a more informed and pondered decision.

It is not uncommon in the Portuguese market´s usages for credit institutions to provide the consumer with the standardised information sheet incorporating the credit agreement conditions and the draft of the credit agreement (as required by the MCD), but making it, however, conditional upon the confirmation of the property valuation by the independent appraiser.

Upon this scenario, we believe that the 30-day period during which the creditor remains mandatorily bound by the contractual offer does not start counting until it confirms the approval of the credit contract without any conditions or caveats, thus leaving the decision to enter into the contract to the entire and exclusive discretion of the borrower. It is only when these conditions are met that the seven-day minimum reflection period begins.[11]

Another novelty derives from the transposition of Art. 17(6) *in fine* MCD by Art. 15(7) DL 74-A/2017, establishing that when the borrowing rate is not capped, the information about the possible impact of variations on the amounts payable and on the APRC must be accompanied by a warning that the total cost of the credit for the consumer, represented by the APRC, may suffer changes.

One of the most important innovations brought to the Portuguese legal system by the transposition of the MCD relates to the imposition of the duty to assess the creditworthiness of the borrower by the financial institution and the setting of a legal prohibition on contracting when the result of this assessment is negative (Art. 16(2) DL 74-A/2017).[12] This solution entails an effective limit on contractual freedom and must be approached and implemented with caution and balance.

Art. 16(1) DL 74-A/2017 states that before the contract is concluded, the lender must assess the consumer's creditworthiness based on the relevant factors to verify the borrower's ability and willingness to perform the contractual obligations. This assessment must essentially be based on the consumer's income, expenditures, and other financial and economic circumstances that affect this consumer [Art. 16(1)(a)] and cannot be based predominantly on the value of the property that exceeds the amount of credit nor on the assumption that the property's value will increase, unless the purpose of the credit is precisely to build or carry out work on the property [Art. 16(1)(b)].

The influence that the experience of the subprime crisis had on the shaping of Art. 18(3) MCD and, correspondently, on Art. 16(1)(b) DL 74-A/2017 is obvious, and it is, in my opinion, to be commended.

The procedures applicable to the creditworthiness assessment were developed by Art. 16 DL 74-A/2017 and Aviso do Banco de Portugal 4/2017, 22 September.

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[11] According to Campos & Carvalho (2017) 220, the beginning of the 30-day period depends upon providing the borrower with all the information relating to the contract. As mentioned in the text above, we consider it is not sufficient for the financial institution to provide all the information relating to the contract. It is also necessary that this is accompanied by an unequivocal binding intention to the communicated contractual terms.

[12] On this topic, for all, Duarte (2018) 38 ff.; Passinhas (2018) 459 ff.; Vardi (2022) 144 ff.; Gonçalves (2016) 113 ff.

According to Art. 5 of Aviso do Banco de Portugal 4/2017, when assessing the consumer's creditworthiness, the financial institution must take into account, among other things: a) the nature, amount and characteristics of the credit agreement; b) the consumer's age and professional situation; c) the consumer's income; d) the consumer's regular expenditure; e) the consumer´s obligations deriving from other credit agreements, namely taking into account the information contained in official databases of non-performance of contractual obligations related to credit agreements with financial institutions.

Art. 10 of the said Aviso do Banco de Portugal 4/2017 states that, in assessing the creditworthiness of the borrower, financial institutions must also take into consideration the possible (*rectius*, probable) occurrence of future circumstances with impact on the result of the assessment, such as: a) a possible decrease of income of the consumer after retirement age or the end of the labour contract, if the credit agreement lasts beyond that point in time; b) a potential increase in expenses resulting from the need to guarantee payment of other debts for which the consumer acted as guarantor; c) a possible increase in the value of the instalments resulting from an increase in the interest rate in credit agreements with a variable or mixed interest rate; d) possible changes in the value of the instalments, when the contract includes a grace period on interest or principal payment or the deferred payment of part of the principal.
According to Art. 6 of Aviso do Banco de Portugal 4/2017, the financial institution must ask the consumer to provide the information deemed necessary for the creditworthiness assessment, as well as the documents needed to prove the veracity and currency of the information. The financial institution must also warn the consumer that failing to provide the requested information or documents, or the provision of false or outdated information, will result in the refusal to grant the credit.

In addition, financial institutions must consult credit liability databases. Still, the consumer must be informed in advance of this consultation in accordance with personal data protection legislation (Art. 16(1)(c) DL 74-A/2017). Art. 16(1)(d) DL 74-A/2017 grants financial institutions a margin of discretion in consulting databases that they consider relevant for assessing the consumer's creditworthiness, provided that the applicable legal provisions on the protection of personal data are respected. This last provision leaves room for consulting databases created by resorting to big data.[13]

[13] On this topic and the caution it entails, for all, Leal (2020) and Moreira (2023).

The violation of the duty to assess the consumer's creditworthiness by the creditor constitutes a misdemeanour and is punishable in the terms of Art. 210 RGICSF.[14] However, experience shows us that these administrative sanctions tend to be manifestly insufficient compared to civil sanctions, such as contractual liability, tort, or contract invalidity.[15] *De iure condito*, it seems that the violation by the lender of the duties enshrined in Art. 16(1), (2) and (3) DL 74-A/2017 can give rise to pre-contractual liability of the creditor towards the consumer, according to Art. 227 of the Portuguese Civil Code. The amount of damages corresponds to the difference between the amount of credit granted and the amount of credit that should have been granted in the light of the client's creditworthiness.[16]

On the other hand, the creditor can only terminate or alter the content of the credit agreement when the inadequacy of the creditworthiness assessment is due to the fact that the borrower deliberately omitted or falsified information that he or she provided for that purpose (Art. 16(5) DL 74-A/2017).

III Insufficiencies of (the Transposition of) Directive 2014/17/EU in Portugal

The cultural specificities of each EU Member State strongly influence the contours and legal challenges connected to the mortgage credit regime.

One first significant difference regarding the importance of this topic throughout the European Union relates to the cultural habit of home ownership.

According to data from Eurostat,[17] in 2021, 70% of the European Union population owned the house they lived in, while 30% lived in rented housing. The percentages, however, may vary enormously depending on the country. For example, in Romania, 95% of the population lived in a household owning their home, followed by Slovakia, with a percentage of 92% in 2020 data, and Hungary, with the same rate. On the other hand, Germany has a little under 50% percentage of home ownership, followed by Austria, with 54% and Denmark at 59%. Portugal occupies the twelfth position, with 78.3% of the population living in a household owning their home in 2021, whereas 21.7% lived in rented households.

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[14] For a comparative perspective on the consequences of the infringement of the duty of assessment and the duty to deny in case of negative assessment, Vardi (2022) 181 ff.

[15] Previously expressing the same idea, Carvalho (2018) 322-323; Rebelo (2023) 259; Moreira (2023) 34.

[16] Passinhas (2018) 467. Also, internationally, Arroyo Amayuelas (2017) 15.

[17] https://ec.europa.eu/eurostat/cache/digpub/housing/bloc-1a.html

A second significant difference relates to the typical profile associated with the average mortgage credit debtor. For example, in Portugal, the average mortgage credit debtor belongs to the social classes with higher disposable income, who offer better solvency guarantees, averaging 35-44 years of age, university-level education, and holding an open-ended work contract.[18] This partly explains why, in Portugal, between 2009 and 2013, the default rate in consumer credit rose from 6.7% to 12.7% while the default rate in mortgage credit rose only from 1.6% to 2.4%.

Apart from the provisions related to pre-contractual information through the European Standardised Information Sheet (ESIS) and the standard for calculating the APRC, the European Union opted for a minimum harmonisation strategy in the MCD. According to its Recital 7, the choice of a minimum harmonisation strategy is precisely justified by the:

> 'specificity of credit agreements relating to immovable property and differences in market developments and conditions in Member States, concerning in particular market structure and market participants, categories of products available and procedures involved in the credit granting process'.

This choice contrasts with the full harmonisation character of Directive 2008/48/EC, repealed by the very recent Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers.

Even though the choice of a minimum harmonisation strategy may be understandable, given the sensitivity of the topic and the sharp cultural discrepancies between countries, the fact is that it entailed the danger of hindering the promotion of the two primary purposes set by the Directive itself, in Recitals 2, 3 and 4. The first purpose was to promote legal harmonisation within the European Union countries on consumer credits relating to residential immovable property, stimulating the promotion of the development of cross-border activity and the creation of an internal market for credit agreements relating to residential immovable property (Recital 2). The second purpose was to discourage the adoption of risky behaviour by financial institutions, limiting the irresponsible lending practices at the root of the 2007 crisis by restoring consumer confidence in the financial sector (Recitals 3 and 4).

Regarding the first purpose, the Directive seems to have fallen short of its self-proclaimed aim of 'creating an internal market in credit agreements for residential

[18] Santos, Teles & Serra (2014) 34 ff. For a recent brief characterisation of mortgage lending in Portugal, Guimarães (2022) 205-207.

property', considering the low volume of cross-border activities in mortgage lending. This is undoubtedly acknowledged by the European Commission's Final Report on the Evaluation of the Mortgage Credit Directive (Directive 2014/17/EU) dated November 2020[19] and on the Report from the Commission to the European Parliament and the Council on the review of the Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property, dated May 11, 2021.[20]

As to achieving the second purpose, the search for the lowest common denominator meant that the Directive often adopts vague language with a highly programmatic tone and is not very ambitious or incisive in its consumer protection requirements.
In Portugal, the proximity of the legal regime resulting from the transposition of the MCD to the text of the MCD itself has resulted in an insufficient legal response to two of the most relevant problems related to consumer protection within mortgage credit agreements: a) the effects of substantial variations of the interest rates, on the one hand; b) mortgage enforcement within a complete full recourse system, on the other hand.

According to recent data from the Bank of Portugal, in March 2023, the total percentage of mortgage credit agreements concluded in Portugal with fixed rates was less than 5%, while the variable rate mortgage credit agreements represented more than 75%.[21] This information is especially relevant if one considers the recent study from the European Datawarehouse,[22] proving that, between 2022 and 2023, the delinquency trend indicator increased the most in countries where variable interest rates are commonly used, while it remained stable in countries where fixed interest rates are predominant. This suggests that, in the context of increasing interest rates such as the one we are experiencing now, the interest rate type more commonly used in a country is a crucial determinant of loan performance.

The most commonly used index in Portugal is the 12-month Euribor rate, closely followed by the 6-month Euribor rate.

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[19] Available online at https://op.europa.eu/en/publication-detail/-/publication/e4a1db26-2f94-11eb-b27b-01aa75ed71a1

[20] Available online at https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:52021DC0229

[21] Available online at https://bpstat.bportugal.pt/dominios/186

[22]Available online at https://eurodw.eu/are-variable-interest-rates-driving-up-mortgage-delinquency-rates/

Since 2017, Euribor has oscillated from negative values around -0.274% to -0.509% in 2020; -0.534% in 2021; 2.56% in 2022; 4.065% in 2023 and around 3.871% in 2024.

These accentuated oscillations of the Euribor rate in the last seven years have resulted in two very different scenarios regarding mortgage credit agreements and consumer protection.

The first challenge faced by DL 74-A/2017 was to determine how the negative interest rates should be reflected on the instalments to be paid by the borrowers. Two questions were posed: first, whether the negative value of Euribor should be reflected in the fixed amount of the spread, being deducted from its value; secondly, and more sensitively, whether, in cases where the negative value of Euribor exceeds the positive value of the spread, negative interest should be applied by the financial institutions, with an impact on the reduction of the value of the principal owed. The debate was intense, both on a political and a doctrinal level, with advocates on both sides.[23]

The discussion was settled by a legislative intervention, resulting in the first amendment to DL 74-A/2017 by adding Art. 21-A, by DL 32/2018, 18 July. According to this norm:

'1. When the interest rate calculation results in a negative value, this value must be reflected in the credit agreements provided for in Article 2.1(a). 2. For the purposes of the previous paragraph, the negative value calculated must be deducted from the principal owed on the instalment due. 3. Without prejudice to the provisions of the previous paragraph, the lender may choose to set up credit in favour of the customer for an amount identical to the negative values calculated under the terms of paragraph 1, to be deducted from the interest due, from the moment the latter becomes positive, with the interest due being deducted from the credit until it is extinguished. 4 - If at the end of the period agreed for the credit agreement, there is still a credit in favour of the client, the credit institutions must repay it in full.'

Some interesting notes concerning this norm should be highlighted.

First, this solution came into force on the day following its publication and was applied immediately to the instalments due under ongoing contracts without the need

[23] Advocating the application of the negative Euribor rate to ongoing contracts, even in cases where this resulted in an interest rate below zero, with an impact on the value of the principal owed, Barbosa (2016), Barbosa (2018), Cardoso (2016). Differently, advocating that the application of the negative interest rate cannot impact (reduce) the value of the principal owed, Vasconcelos (2017), Pires (2017a), Moura (2017), and Costa (2018).

to amend the respective contractual clauses and by means of an exceptional revision of the value of the index used to calculate the applicable interest rate.

Second, the Portuguese legislator restricted the application of this solution only to credit agreements for housing (Art. 2(1)(a) DL 74-A/2017), not extending it to credit agreements for the acquisition of immovable property for non-housing purposes [Art. 2(1)(b)], nor to credit agreements which, regardless of the purpose, are secured by a mortgage or equivalent guarantee or right relating to immovable property [Art. 2(1)(c)]. As already argued,[24] this restriction of the scope of application of Art. 21-A to home loans is an indicator that the legislator recognises that this regime is contrary to the nature of credit agreements (in which at least the return payment of the principal owed should be safeguarded), being itself an exceptional regime motivated by concerns guided towards protecting the consumer in housing credit.

This solution also raises relevant questions about the admissibility of interest rate floor clauses, due to the combination of Art. 21-A with Art. 35(1), according to which consumers cannot waive the rights conferred on them by DL 74-A/2017. The combined interpretation of both norms seems to lead to the conclusion that these clauses are inadmissible in housing credit agreements.[25]

However, the scenario related to interest rate oscillation has radically changed in the last two years, with dramatic consequences for Portuguese households.

The fall in Euribor in the aftermath of the economic crisis has led many Portuguese families to take out mortgage credit loans. For example, between 2014 and 2015, the number of new housing loans rose by 51%; between 2015 and 2016, it rose by 34.2%.[26] The sharp rise in the Euribor rate from 2022 onwards meant a concomitant increase in the instalments due by consumers. For example, in 2023, the average home loan payment in Portugal increased by 35%.

The solutions provided by the transposition of the MCD have revealed themselves to be insufficient and incapable of adequately attending to the inflation scenario described above.

On the one hand, pre-contractual duties of information have proven to have a restricted positive impact both in order to provide the framework for conscious and

[24] Costa (2018) 95.

[25] Barbosa (2018) 814 ff., Pires (2017b) 3 ff., and Costa (2018) 96 ff.

[26] Banco de Portugal (2015) 77 and Banco de Portugal (2016) 71.

informed decisions by consumers,[27] and in providing an effective reflection of the consumer's right to choose.

Nevertheless, given the economic situation, the Portuguese legislator decided, through DL 20-B/2023 of 22 March, to include a new number 10 in Art. 13 DL 74-A/2017, comprising a new obligation on the contours of the pre-contractual information given to the borrower: the requirement that, when the credit agreement is for the purchase or construction of a permanent home, the borrower must also present the consumer with a standardised information sheet simulating the conditions of the credit agreement for variable, fixed and mixed interest rate modalities, and then a proposal for a credit agreement with the interest rate type chosen by the consumer. On the other hand, even though the creditworthiness assessment is supposed to take into consideration the occurrence of possible future circumstances, this judgement relies necessarily on a prognosis and lacks, therefore, certainty. One must bear in mind that tightening the judgement on creditworthiness assessment on the prospect of a potential increase in variable interest rates comes with the cost of a limitation to contractual freedom of the parties, and, concomitantly, with the likely cost of excluding families from the ownership of their households.

The balance is, therefore, very fragile and may depend upon the circumstances at each moment in history.

Art. 10 of Aviso 4/2017 of Banco de Portugal tries to find that balance, determining that, in the case of a variable or mixed interest rate credit agreement, the credit institution must assess the impact that an increase in the index will have on the consumer's future solvency. Considering the cultural relevance of this issue in Portugal, and even though it already implicitly results from the assumptions associated with the creditworthiness assessment, it would have made sense for this obligation to have been enshrined in the national law that transposed the Directive, which would have been fully justified in Art. 16(1)(b) DL 74-A/2017.

The terms for assessing the impact that an increase in the index will have on the consumer's future solvency are enshrined in Instrução 23/2023 of 9 October of Banco de Portugal. Instrução 23/2023 has replaced Instrução 3/2018 of 1 February, so that currently the increase in interest rate to be considered in the simulation is reduced from 3 percentage points to 1.5 for credits with a duration of more than ten years. Although this solution may be understandable in a historical context where it is

[27] On the difficult choice between a corrective model and an informational model in banking law, Pires (2013).

assumed that the Euribor has reached a peak and is expected to fall in the coming years, it is still very fragile to consider, in a so-often lifetime contract.[28]

The impact of a sharp rise in variable interest rates is particularly relevant given that Portugal has adopted the full recourse system regarding mortgages, which means that the enforcement of the mortgage, its assignment, or the voluntary surrender to the bank of the family home may not be sufficient to pay the debt in full, leaving private individuals not only deprived of their homes but also legally obliged to pay the outstanding amount of the debt.[29]

The lack of an adequate legal framework for the assignment of non-performing loans is yet another factor that has the potential to severely constrain the protection of consumers in Portugal, given that often the credit purchaser is not a financial institution in the sense of Art. 4(1)(o) DL 74-A/2017, and thus is not bound by its provisions.[30] Even though Directive 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit services and credit purchasers was designed to approach the problems related to the purchase of non-performing loans, establishing safeguards and protection for debtors, this Directive has still not transposed in Portugal at the present moment, although the deadline finished on December 29, 2023.

The topic of the assignment of non-performing credits covered by DL74-A/2017 by the financial institution to a third party not bound by its legal regime was the object of attention in the recent decisions from Guimarães Court of Appeal (acórdão TRG, n.º 5520/18.8VNF-A.G1, 20 January 2020) and Porto Court of Appeal (acórdão TRP n.º 7748/17.9T8PRT-B.P1, 10 March 10 2022).[31] In both cases, the Courts decided that the assignments of the non-performing credits were illegal and, therefore, not valid, based on Art. 577(1) of the Portuguese Civil Code (according to which the assignment

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[28] Analysing household credits from the perspective of lifetime contracts and its consequences, Fonseca (2016).

[29] Underlining the debtor's 'personal tragedy' in these cases, Leitão (2015) 10. The full recourse system may be excluded by the agreement of the parties, as stated in art. 14(3)(b) of DL 74-A/2017. However, as mentioned by Vasconcelos (2021) 214, the relevance of this solution is minimal since the bank has no interest in its adoption. On the impact of the full recourse system during the 2007 economic crisis, for all, Barbosa & Campos (2012), Campos (2012), Câmara (2013), and Raposo (2016).

[30] On this topic, Passinhas (2021) 96 ff.

[31] Also stating that the assignment of the credit cannot affect the rights of the consumer conferred by DL 74-A/2017, the decision of Coimbra Court of Appeal of 28 March 28 2023 (Acórdão TRC n.º 2194/20.0T8SRE.C1) and the decision of Guimarães Court of Appeal of 4 November 2021 (Acórdão TRG n.º 3046/17.6T8VNF-F.G1). All decisions are available at www.dgsi.pt

of credits is forbidden when the law so states) and Art. 37(1) DL 74-A/2017 (according to which the transformation of a credit agreement subject to DL 74-A/2017 into a credit agreement excluded from its scope constitutes fraud and is, therefore, void).

In the words of TRG:

'[i]t is easy to see that this would represent an authentic fraud, insofar as it would completely frustrate the purposes behind the establishment of that special regime that aims to protect consumer-borrowers who are in default [namely, I add, through the possibility of the resumption of the credit agreement enshrined in Art. 28 DL 74-A/2017], a solution that must be rejected' (translation by the author).[32]

IV Conclusions

In summary, it is possible to conclude that the transposition of the MCD did not entail any disruptive changes in the Portuguese legal regime on housing credit compared to the previous existing regimes, which already offered a higher level of protection than that imposed by the Directive on many points.

In fact, one of the most important contributions of the transposition of the MCD into the national legal system was the aggregation and systematisation of a significant part of the previously dispersed legislation, making the legal framework more accessible and comprehensible to the consumer.

Another relevant contribution from the transposition of the MCD into the Portuguese legal system was the innovative regulation of credit intermediation activities and the provision of consultancy services, transposed by DL 81-C/2017, 7 July, and the introduction of new rules on the remuneration policies of the staff involved in drawing up, marketing and granting of credit agreements, as well as the legal imposition of knowledge and competence requirements for these employees (Arts 5 and 6 DL 74-A/2017, 23 June).

Regarding the rights and duties of the contractual parties, the transposition of the MCD also introduced in the Portuguese legal system the mandatory minimum reflection period of seven days, during which the consumer is prevented from

[32] Acórdão TRG, n.º 5520/18.8VNF-A.G1, from January 20, 2020: 'Tal representaria, fácil é de ver, uma autêntica fraude à lei, na medida em que frustraria por completo os objectivos que presidiriam à consagração daquele especial regime que visa tutelar as situações dos clientes bancários que se encontrem em mora relativamente ao cumprimento de obrigações decorrentes de contratos de crédito, solução essa que deve ser rejeitada'. Available online at www.dgsi.pt

accepting the contractual offer (Art. 13(5) DL 74-A/2017), and the duty to assess the creditworthiness of the consumer by the lender and the setting of a legal prohibition on contracting when the result of this assessment is negative (Art. 16(2) DL 74-A/2017).

As for the mandatory minimum reflection period, it should be held it does not start counting until the borrower has all the information related to the contract and the financial institution has expressed a serious and unconditional intention of being bound to those contractual terms.

With regards to the consequences of the infringement of the duty of creditworthiness assessment or the duty to deny credit in case of a negative assessment, besides the administrative sanctions enshrined in Art. 29(v) to (ab) DL 74-A/2017, civil sanctions might be called upon when the requirements of pre-contractual liability are met in the specific case.

The transposition of the MCD in Portugal has, however, failed to provide consumers with adequate protection regarding steep oscillations of the interest rate, as was the case during the last decade. From a scenario of negative interest rates and its impact on the principal owed to a scenario of high growth of the Euribor and its effect on the ability of families to bear the increase of the instalments due, the Portuguese legislator has felt the need to intervene repeatedly since 2018, to create specific legal measures to counterbalance the market fluctuations.

The lack of an adequate legal framework for the assignment of non-performing loans is yet another factor that has been creating relevant disruptions in the protection of consumers in Portugal, leaving this protection to the intervention of the Courts.

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CHAPTER 12
MORTGAGE LOANS IN ROMANIA. (STILL) STRUGGLING WITH THE INHERITANCE OF THE PAST

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I Introduction

Presentation and assessment of the specific consumer protection regulatory needs in Romania on the mortgage loan market and the impact of EU legislation requires understanding the factors and actors framing consumer protection in the field of mortgage loans and a broader view on the regulatory landscape. The mortgage loan directive is only one tool of the complex regulatory mechanism framing the mortgage loan market, where Directive 2014/17/EU (MCD) is being constantly limited in its effects by other pieces of legislation, by ineffective market surveillance and judicial enforcement. The interplay of mortgage loan regulation, unfair contract terms law and unfair commercial practices law is obvious in the Romanian market. Ineffective legislation or weak market surveillance in one of these fields has spill-over effects onto the others. A systemic approach on these three fields is needed in order to understand the driving forces in search for solutions at EU and at domestic level for a better regulation of mortgage loans.

This chapter will present and discuss the implementation of the MCD in Romania from such a perspective in search for answers lying in domestic and EU conditionalities. Section II starts with a general perspective on the specific regulatory needs of the Romanian mortgage loan market; Section III presents the transposition of the MCD in Romania, including subsequent amendments to the implementing law and assessment of the implementing law by the Romanian Constitutional Court; Section IV discusses two categories of infringements in the Romanian market that are representative of the weak effectiveness of mortgage loan enforcement in Romania; Section V summarises lessons to be learned from the Romanian implementation and enforcement of the MCD for future amendments of the EU legislation.

II Specific Regulatory Needs of the Romanian Mortgage Loan Market

Romania became one of the most over-indebted countries after the global financial crisis hit Europe in 2008, along with Spain, Hungary, Greece, Iceland and Portugal.[1] Its cultural, economic, social and political conditions that drew to consumer over-indebtedness impact even today the functioning of the consumer loan market and consumer loan legislation, including mortgage loans. These are: housing and credit bubble; irresponsible borrowing due to low financial literary of the population; weak surveillance of the market of consumer loans including mortgage loans; poverty of the population; absence of a social housing system; the culture of owning homes instead of renting homes; unfair commercial practices and unfair contracting practices in the field of mortgage loan agreements; the large-scale use of highly risky financial products such as loans paid in national currency but denominated in a foreign currency, usually CHF;[2] low deterrence of sanctions and penalties for infringements of consumer protection legislation on mortgage loans, which resulted in low liability risks and liability costs for banks; weak private enforcement and low litigation culture of the Romanian consumers.

The high amount of loans continues to expose the Romanian consumers to over-indebtedness and to high risk of default. In the period of 2007-2021 credits granted to

[1] Andresan-Grigoriu & Moraru (2015) 117-136.

[2] Andresan-Grigoriu & Moraru (2015) 121-123.

consumers in national currency increased 57 times, whereas loans granted in foreign currency increased 16 times.[3] Over 1 billion EUR was recovered from Romanian consumers in 2017-2020 and 1 out of 5 Romanians was subject to debt collection in 2020.[4] According to EUROSTAT statistics on people at risk of poverty or social exclusion, Romania was leading the ranking list with 32.0 against the EU average of 21, 4.[5] Gross domestic savings of Romania was 20.9 in 2023.[6] Private sector debt was 40.40 % of the GDP in December of 2023, according to the EUROSTAT.[7] Household consumption expenditure of Romanians was 16.9 in 2023.[8] Household debt reached 52.4 USD billion in December 2023, representing 14.7% of the country's nominal GDP.[9] Mortgage loans in Romania were at 8.6% of the GDP.[10] The unemployment rate was 5.5%[11] and the inflation rate was 5.8 % in May 2024, the latter being the highest annual rate in the EU. The share of household expenditure on food and non-alcoholic beverages was 27.6% of the total household expenditure in 2023.[12]

Demand for loans continues to increase. On 5 July 2024, there were 856 credit intermediaries conducting activities in the Romanian market registered at the National Authority for Consumer Protection (NACP). In 2020, 14 non-credit institutions were granting mortgages in Romania and only 14 credit intermediaries were registered in 2020, whereas in 2022 over 600 credit intermediaries were acting on the Romanian market.

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[3] Stanescu (2023) 105.

[4] Stanescu (2023) 105.

[5] See Eurostat, Living consitions in Europe – poverty and social exclusion (2023). Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?oldid=575050

[6] See World Bank, Gross domestic savings (% of GDP) – Romania (2023). Available at: https://data.worldbank.org/indicator/NY.GDS.TOTL.ZS?locations=RO

[7] See Trading Economics, Romania - Private sector debt, consolidated - 2024 Data 2025 Forecast 1995-2023 Historical (2024). Available at: https://tradingeconomics.com/romania/private-sector-debt-consolidated-eurostat-data.html

[8] See World Bank, General government final consumption expenditure (% of GDP) – Romania (2023). Available at: https://data.worldbank.org/indicator/NE.CON.GOVT.ZS?locations=RO

[9] See CEIC Data, Romania Non Performing Loans Ratio, 2014 – 2024. Available at: https://www.ceicdata.com/en/indicator/romania/non-performing-loans-ratio

[10] See Property Forum, Mortgage loans in Romania at 8.6% of GDP (2021). Available at: https://www.property-forum.eu/news/mortgage-loans-in-romania-at-86-of-gdp/8404

[11] See Trading Economics, Romania Unemployment Rate (2024). Available at: https://tradingeconomics.com/romania/unemployment-rate

[12] See Eurostat, Household budget survey - statistics on consumption expenditure (2023). Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?oldid=595230

Romania continues to struggle with the inheritance of past unsolved regulatory needs of consumer mortgage loans that manifest themselves and impact on the implementation and enforcement of different pieces of EU legislation, which directly or indirectly concern mortgage loans, such as those relating to unfair contract terms or unfair commercial practices. The lack of a systemic and unitary approach at EU level manifests itself strongly in Romania, and due to this the effectiveness of the mortgage loan legislation is further weakened by deficient enforcement of unfair contract terms law and unfair commercial practices. Hence the deterrent effect of the implementing legislation is low, consumer protection is weak, old practices of financial institutions continue to persist, and banks are encouraged to test new ways to hinder, block or avoid enforcement of EU legislation on mortgage loans. As result, many consumers in Romania still struggle with the lack of justice provision in mortgage loan agreements concluded before the global financial crisis hit Europe or afterwards; misleading contracting practices continue to be preceded by misleading advertising and other unfair commercial practices; lack of effective solutions to allocate damages to consumers when the contract is found unfair persists; assignment of performing loans by banks to non-financial commercial entities located outside Romania and in some cases outside the EU is frequent. All of these issues hamper effective consumer protection in the field of mortgage loans.

Local market surveillance authorities lack resources and capabilities when enforcing consumer financial protection rules; hence debates on the activity of the National Authority for Consumer Protection (NACP) in the area of consumer finances is highly politicised and rarely involves consumer scholars, whereas public opinion, the banking sector and consumers opinion on abuses is conflicting.[13] Empirical data contrast with the lack of studies on the topic. Such data well illustrate the magnitude of the problem and the impact of over indebtedness on the consumer's life. Only very few academic papers debate the effectiveness of market surveillance and enforcement of mortgage loan legislation in Romania.[14] Consumers usually learn from the mass media and webpages of consumer associations about abusive bank practices, investigations of the NACP and court judgements. However, such channels do not offer updated information about the outcome of investigations and enforcement of administrative court decisions that would enable them to claim damages in civil law court suits.

The NACP is the central market surveillance authority in charge of enforcement of unfair contract terms law, unfair commercial practices law, and mortgage loans. It can make market investigations on its own motion or based on consumer/consumer organisation complaints, impose administrative fines, order termination of the

[13] Critically on the activity of the NACP in consumer finances see Stanescu (2023) 102.

[14] Stanescu (2023) 102.

infringement, assign the publication of the administrative decision and bring the creditor to administrative court when it finds the terms unfair or establishes that the commercial practice is unfair. The administrative procedure is free of charge for the consumers and quicker than the civil court action. However, the administrative decision finding contract term unfairness is a declaratory one and does not deal with the issue of damages. Law 193/2000 on unfair contract terms does not contain sanctions for non-compliance with the court decision to amend existing contracts. Unfair commercial practices against Romanian consumers of mortgage loans are frequent. Law 363/2007 transposed the requirements of Directive 2005/29/EC in rather a formal than functional manner. For the consumers it is difficult under the principle-based approach of EU law to identify unfair practices and it is rare that, after an administrative investigation, they go to court against infringing companies to ask for damages.

The efforts of the Romanian Government to complement the EU legislation with other laws that would enhance financial consumer protection and that of the judiciary to effectively implement EU-rooted consumer legislation are often delayed and jeopardised by the financial sector and political decision makers who use and abuse the tool of constitutional control.[15]

III Transposition of Directive 2014/17/EU

1 The 2016 Transposition by GEO 52/2016

The transposition of the MCD took place in Romania with delay at end of 2016 after the Government was summoned by the European Commission with an EU Pilot procedure for non-transposition of the EU Directive within the required deadline. For this purpose a new law was enacted, the Government Emergency Ordinance (GEO) 52/2016, that also amended the previous legislation on consumer loans.

The Preamble of GEO 52/2016 enlisted in 2016 the regulatory needs for special legislation on mortgage loans in the context of market developments: a) financial-economic difficulties that consumers may face because of changes in foreign currency exchange rates and other unforeseen aspects of mortgage loans, which require for urgent measures that strengthen the financial education of the consumers for more responsible borrowing and better management of loans; b) quick development of loan collecting activities and tendency of the creditors to assign their receivables to debt collecting commercial entities and the lack of an adequate framework for the relationship between the consumers and the debt collecting companies require for urgent legislative measures; c) the high level of penalties for late payment in case of mortgage loans on immovables may present a high financial burden in case of

[15] For more details, Stanescu (2022).

mortgages on homes, as these situations become too risky for the consumers if the mortgage is to be enforced and they will be evicted from their homes. Therefore, consumer protection rules against evictions and against the assignment of loans to debt collecting companies are required.

The first regulatory need mentioned in the Preamble aims at minimising the risks of exchange rate fluctuations, which the consumer must be aware of before taking out the loan. Therefore, in the legislator's view, it is important for the consumers to limit such risks for the duration of the loan agreement by adequate legal provisions. It should be noted, however, that the most important cause of consumer over-indebtedness in Romania are the loans granted in the past in national currency but denominated in foreign currency, mostly in CHF, where the unfair contract terms allocating entirely to the consumer the risk of exchange rate fluctuations were enhanced by contract terms that allowed the bank to establish and modify unilaterally the exchange rate. It is interesting to highlight how the legislator's argument leads to allocating the whole responsibility of not entering into such contract on the consumer, and thus measures to educate the consumers are envisaged. No mention is made of the responsibility of the banks for trading such products and for the use of unfair terms and unfair practices, since these issues constitute the subject matter of other EU legislation transposed into Romanian law.

The second regulatory need stated by the Romanian legislator is searching for a solution with regard to the introduction in the market of new debt collecting solutions, such as the assignment of performing loans to debt collecting companies. However, the Preamble did not mention another growing tendency in the Romanian market, that of assignment of performing loans to non-banking commercial companies usually outside Romania, so that the transitions and subsequent acts of the purchasing companies fall outside the reach of the Romanian authorities and outside the reach of mortgage loan and banking supervisions legislation. Non-financial institutions outside Romania that do not have subsidiaries or other secondary entities registered in Romania fall outside market supervision related to mortgage loan activities.

The third regulatory need mentioned in the Preamble continues to be relevant even nowadays. Thousands of Romanian families became victims of over-indebtedness and face the risk of losing their homes because of the high penalties in case of late payment of instalments and interest rates due to either unfair terms or other abusive contracting and marketing practices.

By the enlisted regulatory needs, the legislator acknowledged the low performance of the private law tools such as unfair contract terms law, that should have effectively cured years ago the problem of loans denominated in foreign currencies and that of unfair interest rates, as well as of the lack of domestic rules on loan assignment in case of mortgage loans.

The MCD was enacted in Romania at a moment when Romanian consumers were on the way to be deprived of the protection granted under EU law due to repeated cases of loan assignments to non-banking entities abroad and the Romanian authorities and courts had no legal tools suitable to prevent such cases.

The new legislation entered into force on 30 September 2016, leaving to creditors less than 10 days to adapt their pre-contractual and contractual documentation and procedures to the new legal requirements.

1.1 The Material Field of Application of GEO 52/2016

Besides transposing into national law, the provisions of the MCD, including provisions on advertising and marketing, pre-contractual and contractual information, advisory services, loans in foreign currency and assessment of consumer's creditworthiness, GEO 52/2016 contains additional rules applicable to the credit granted to consumers for immovable property (residential or not), but also to consumer credit in general, irrespective of purpose. Under pressure coming from the EU, the aim of the Romanian legislator was to enhance consumer protection through the implementing law by creating a unitary framework for consumer transactions concerning immovables. Guided by such purpose, Romania has not excluded the equity release credit agreements enlisted in Art. 3(2)(a), nor those mentioned in Art. 3(2)(d)(e)(f) MCD. Romania also did not make use of the provisions of Art. 3 (3) and (4) that allows other exceptions in addition to those enlisted in Art. 3(2).

The definitions included in Art. 4 MCD have a major role in the uniform implementation and enforcement of the EU-rooted rules. However, the Romanian legislator adopted a slightly different definition of 'creditor' to that provided by the MCD, in response to then existing practices whereby some of the banks in Romania sold/assigned performing loans to commercial companies located outside Romania, and as a result, Romanian consumers could not benefit from the protection granted under the Romanian laws. Under this approach, 'creditor' means legal persons, including the branch of a financial institution or of a foreign financial institution that offers credit services in the territory of Romania in compliance with Art. 2 GEO 99/2006 on credit institutions. In addition, GEO 52/2016 also applies to non-banking financial institutions conducting commercial and professional activities under L 93/2009. In this way, the legislator excluded natural persons offering credit services from the regulatory framework imposed by the MCD and included non-banking financial institutions.

Another novelty in the Romanian list of definitions is that of 'credit intermediary'. According to the Romanian definition this may be a legal person or a natural person authorised to carry out commercial, business or professional activities against payment, who directly or indirectly introduces the creditor or another credit intermediary carrying out at least one of the following activities: a) presents to consumers loan agreements, b) assists the consumers by undertaking preparatory work or pre-contractual administration other than those enlisted at a); c) concludes the loan agreements on behalf of the creditors.

While the Directive defines the non-financial institution in general terms and broadly as any creditor that is not a credit institution, the Romanian law defines more specifically and narrows the term, starting with restricting it to legal persons conducting exclusively crediting activity with public funds or entrusted with such funds by intergovernmental agreements registered in the Registry provided for by Art. 5(g) Law 93/2009, as well as the immovable developer providing the type of loans mentioned in Art. 2(1).

1.2 Provisions on Credit Intermediaries and Debt Collection Entities

GEO 52/2016 regulates credit intermediaries and debt collection entities, establishing organisational requirements, conditions on professional competence, on registration, requirements on business conduct and in the case of debt collection entities, a minimum share capital of RON500,000. According to GEO 52/2016, credit intermediaries and debt collection entities have to register at the NACP and must take up professional insurance. They have also to register as personal data processors in compliance with the Romanian legislation on data protection.

Theoretically, from 1 January 2017 only debt collection entities registered with NACP can perform debt collection activities on the Romanian market. Such entities must have a registered office, a branch or a representative in Romania for the settlement of potential disputes and for liability for administrative fines or criminal law sanctions imposed by the Romanian authorities; they must prove that the persons responsible for the management and supervision of the activities have a good reputation and possess adequate knowledge and experience considering the nature, size and complexity of the envisaged activities; they should not establish the remuneration and incentives for their personnel solely based on goals related to the recovery of the debts or exclusively linked to the recovered amounts.

The legal analysis has shown that before the 2024 Law (GEO 15/2024, see below 3.4) no register was available in Romania on credit intermediaries, unlike in other EU Member States. On the webpage of the European Banking Authority even today the list of credit intermediaries in Romania is missing.

Art. 15 MCD adds more requirements, which include the provision of information to consumers on banking fees payable for their services in relation to the credit agreement. Member States may also ban banking fees paid by the creditor to the credit intermediary.

1.3 Sanctions

Pecuniary sanctions are extremely low in Romania for infringement of GEO 52/2016, thus in practice these are not a deterrent at all for the financial institutions and credit intermediaries. They range from RON10,000/20,000/30,000 to a maximum of RON100,000. In EUR the maximum level of pecuniary sanctions is around EUR 20,000, which is a ridiculously low sanction for a credit institution infringing consumer protection law concerning long-term mortgage loan agreements.

According to Art. 123(1) complementary measures may be also imposed by the NCPA, such as: immediate compliance with the infringed contract terms; reimbursement to the consumers of the money charged illegally under contract terms declared unfair by a final court judgement within 15 days; amendment of the contract in line with the legal requirements within 15 days; amendment of all similar contracts to bring them into compliance with legal requirements within 30 days; suspension of advertising activities infringing the law until entering into legality and withdrawal of advertising materials. In case of non-compliance with the above complementary measures or repetition of the same infringement within 60 days by the same business entity, the NACP may impose additional pecuniary sanctions ranging from RON 80,000-100,000.

1.4 Rules in Addition to those Implementing Directive 2014/17/EU

Additional rules provide, among other, limitations of the rights or additional requirements for the creditors in case of financial difficulties of the borrowers and in relation to the enforcement against defaulting borrowers, including: a) a cap of the rate of default interest to 3% above the current interest rate, b) default interest can be calculated only over the amount overdue and cannot exceed such amount; c) the lender may accelerate the loan only for overdue payments exceeding 90 days; d) after acceleration, only default interest may be charged, at a rate cap of 2% above the rate of the current interest; d) during the enforcement procedures it is forbidden to charge interest and default interest; f) if the enforcement is not initiated in a maximum six months from the date of acceleration of the loan, starting with the day following the expiry of the six-month term, the creditor cannot charge default interest.

2 The 2019 and 2023 Amendments of GEO 52/2016

In 2019 GEO 52/2016 was amended with a few provisions on loans with variable interest rates to grant more protection to consumers. Then, in 2023 Romania was risking again an infringement procedure under EU Pilot (2023)10462 for defective transposition of the NPL Directive and under this pressure made further amendments also to GEO 52/2016 by Law 134/2023. Next, in 2024, GEO 52/2016 was amended again by GEO 15/2024 within the context of legislative steps taken in response to the earlier EU Pilot (2023)10462.

It is self-explanatory that the transposition of the MCD became the subject matter of an the above-mentioned EU Pilot procedure opened in 2023, six years after the enactment of the Romanian implementing norms. During those six years several cases of abuses have been reported related to assignments of performing loan agreements to non-banking commercial entities. The NACP investigated several cases of such assignments under the Romanian implementing law on unfair commercial practices (Law 363/2007) and issued decisions imposing fines and commenced court actions against banks that sold enforcement titles to non-financial institutions, by this infringing the right of the consumers. However, later the NACP failed to win in court most of such cases.

The new provisions introduced in 2023 by Law 134/2023 to GEO 52/2016 under the pressure of the pending EU Pilot against Romania aimed to enhance consumer information prior to contract conclusion and to better guard over the financial interests of the consumers by further limitations imposed on creditors on fees and charges and more transparent rules in case of foreign currency loans. Important steps were made also in the direction of pursuing the creditor to search for solutions when the consumers face difficulties to comply with their contractual obligations during contract implementation. It also strengthens with specific requirements unfair contract terms law and unfair commercial practices law in the field of mortgage loans, as advanced in 2016 in the Preamble of GEO 52/2016. Finally, stricter provisions on sanctions were introduced in May 2023.

2.1 Provisions Limiting Abusive Charges

The newly introduced Art. 17(2) compels credit institutions to establish fixed charges for file management, account management, and a unique commission for all consumers using the same type of loan, with the same credit institution, for loans granted for the same period. Management fees should be established at the limit of costs effectively incurred by the credit institution for monitoring, registration and operations related to payment of the loan. When such fees are calculated as a percentage, this should be related to the balance of the loan.

2.2 Provisions Enhancing Consumer Information

According to the new Art. 26(1)(b) GEO 52/2016, the creditor must include on the list of compulsory information in case of loans granted in foreign currency the exchange rate of the National Bank of Romania applicable at the date of contract conclusion in the currency of the loan and in national currency. Another provision related to foreign currency loans is Art. 32(2), stating the time limit on the offer and acceptance of offer. The creditor must provide the consumer with an offer within 15 days upon request and the consumer has 15 days to accept or reject the offer. Art. 35(2) prohibits the creditor to charge fees for amendments to loan agreements and to demand additional securities from consumers in such cases. Law 134/2023 introduces by the new Art. 19(4) the prohibition of such contract clauses that grant to the creditor the right to refuse payment of instalments in the currency of the loan.

Consumer information is also strengthened by the obligation of the creditor who assigned loan agreements to a third party, introduced by the new Art. 59(1)(d), to inform the consumers also about the due instalments and the documents justifying the components of such instalments. In order to prevent abuses by debt enforcement companies, Art. 60(j) prohibits the communication by the creditor or the assignee with the consumers between 20:00 pm. and 9.00 am.

Additional reporting obligations were also introduced by Law 134/2023 for debt collecting companies. Under the new Art. 128(13), they have to report to the Credit Risk Centre of the National Bank of Romania data on assigned receivables (loans) according to the rules issued by the National Bank of Romania.

2.3 Provisions Enhancing Consumer Choice

In order to enhance consumer choice, Art. 61(1)(b) GEO 52/2016 introduced by Law 134/2023 provides that not-tied credit intermediaries must analyse a sufficient number of loan agreements available on the whole market, representative of at least one type of contract existing in the offer of all creditors and to recommend at least three contracts adequate to meet the needs of the consumer and adequate to the financial situation and personal circumstances of the consumer.

Concerning the reflection period granted to the consumer before contract conclusion, by Art. 9 GEO 52/2016 introduced by Law 134/2023, an additional restriction was included, so that the creditor's offer is irrevocable during this period of time, with certain exceptions provided for in Art. 9(13). Accordingly, if within the period of reflection the information based on which the creditor made the creditworthiness assessment and/or which was provided by the consumer suffer modifications or if the assessment report or acts concerning the ownership of the immovable that will be purchased were not made available, in such situation the creditor may issue a new ESIS containing the amendment due to the above situations. Art. 9^1 states, in addition, that the creditor must make available on its own webpage a simulator for the calculation of the APRC of the loan, regardless the amount and duration of the loan.

2.4 Provisions Protecting the Consumers in Case of Unforeseen Events during Contract Implementation

A small but significant step is made to the benefit of the consumer by the amended Art. 48 (1) GEO 52/2016, which adds to the list of forbearance solutions in the event of default that the creditor or the debt enforcing company may apply debt reduction. Art. 50(3) compels the creditor to contact the debtor within sixty days of non-payment to obtain information about the consumer's financial situation, and based on such information, to take measures to inform the consumer in writing about adequate solutions to repay the loan.

Law 134/2023 provides by the new Art. 2^1 introduced in GEO 52/2016 the obligation for the creditor to provide, upon the consumer's request, a simulation for each of the following options in case of partial advance reimbursement of the loan: a) maintaining the value of monthly instalments and reduction of the term of the loan; b) reduction of the monthly value of reimbursement instalments under the initial contract duration; c) reduction of the value of monthly reimbursement instalments and reductions of the term of the loan. In addition, the creditor is obliged to inform the debtor about this right and to hand over to the debtor a printed copy of such simulation.

2.5 Provisions on More Severe Sanctions

The provisions on sanctions in case of infringement of GEO 52/2016 were complemented with stricter provisions only on May 2023 by Law 139/2023. According to the new Art. 123(2)(a) and (b), based on the findings of the investigation personnel of the NACP, the NACP may order suspension of the activity of the concerned credit institution until it complies with the legal requirements. The same sanction applies to immovable developers. Art. 123(d) requires from creditor to amend all their contracts of that type in line the legal requirements within ninety days. Last but not least, cancellation of the registration from the NACP Registry may also be applied by the NACP until the credit intermediary or the immovable developer complies with the requirements of the law.

The NACP may also, under the new rule, oblige the creditor to stop charging the amounts established illegally and restitution to the consumer of the amounts charged in the past without legal basis in all similar contracts within thirty days.

2.6 Provisions Enhancing Market Surveillance

Law 134/2023 introduced by Art. 102 GEO 52/2016 provides that all credit intermediaries and or immovable developers (both legal persons and authorised natural persons) asking for registration and fulfilling the conditions for authorisation will be registered in a registry at the NACP into the Registry of Credit Intermediaries and Immovable Developers that is periodically updated and made publicly available on the official webpage of the NACP. The most important, long-awaited measure for enhancing market surveillance was the increase, by Law 134/2023, of the number of jobs at the NACP, with an additional 200 positions as per the new Art. 132(1) GEO 52/2016.

Last but not least, Law 139/2023 amended Art. 120 GEO 52/2016 with a clear provision empowering consumers and consumer associations to submit complaints to the NACP in cases of infringement of the law.

One may wonder why it was necessary to wait for the EU reaction in order to take measures, since the mass media and local consumer protection authorities were sending repeated signals to the NACP and the National Bank of Romania about the state of art in the field of mortgage loans. The MCD allows Member States to enact more stringent rules for the protection of their consumers if needed. Indeed, these realities were ignored and concerning the temporal application of the Romanian implementing law, the drafters of GEO 52/2016 considered, in line with the EU, that the new regime should apply only to contracts concluded after the entering into force of GEO 52/2016.

3 Amendments to GEO 52/2016 by GEO 15/2024

Although GEO 15/2024 was the implementing law of Directive 2021/2167/EU, it also amended other pieces of Romanian legislation on consumer loans, including GEO 52/2016 on mortgage loans. GEO 15/2024 mainly introduced provisions protecting the consumer in case of changes during contract implementation. A set of requirements on contract amendment and solutions in case of unforeseen events impacting contract implementation, such as loan restructuring scenarios, were also introduced by GEO 15/2024. In addition, it finally introduced the mechanism of the MCD providing for the accountability of foreign credit intermediaries acting in a host country market. Such rules were missing earlier from the Romanian legal framework.

3.1 Extension of the Material Field of Application of GEO 52/2016

The field of application of GEO 52/2016 was extended by Art. 2(1)(d) to loan agreements granted to a closed group of persons on public interest considerations, without interest rate or at an interest rate lower than the market rate or under other advantageous conditions, provided that debtors were informed correctly, clearly and unambiguously at the pre-contractual stage about the main characteristics, the risks, and costs connected to the loan.

3.2 Provisions Imposing Conditions on Creditors when Amending Loan Agreements

Concerning contract amendments, the creditor must inform the debtor in advance on the following according to the new Art. 39^1 introduced to GEO 52/2016 by GEO 15/2024: a) a clear description of the proposed changes, indicating whether such changes are subject to creditor consent or apply by law; b) the calendar of implementation of changes to the loan agreement; c) instruments to challenge the modifications; d) the deadline for challenging modifications and the name and address of the competent authority where to submit complaints against contract modifications by the creditor.

3.3 Provision on Loan Restructuring in Case of Unforeseen Events

It is more than welcome that finally the credit institutions are pursued by GEO 15/2024 to make efforts to find solutions in case unforeseen events impact on the performance of the loans, by compelling the creditors to have adequate policies and procedures on loan restructuring in cases of financial difficulties by the debtor before commencing enforcement proceedings. According to the new Art. 45 GEO 52/2016, such measures must take into account, among others, the situations of the consumer and may consist in the following: i) partial or total refinancing of the loan; b) amendment of the terms and conditions of the loan agreement, including i) prolongation of the loan agreement; ii) modification of the type of the loan agreement; iii) postponement of all instalment payments or a part of them for a certain period of time; iv) modification of the exchange rate; v) offering a period without reimbursement of instalments; vi) partial payment; vii) monetary conversion; viii) partial debt forgiveness and debt consolidation.

The new Art. 57^1(1) introduced by GEO 15/2024 stipulates that in case of debt assignment by the creditor to a third party, the debtor will have all the rights against the assignee as it had against the creditor. Paragraph (2) mentions that the debtor must be informed about the assignment, except when the creditor continues to administrate the loan together with the assignee.

3.4 Requirements on Foreign Credit Intermediaries Acting Cross Border within the EU

Implementing rules for Art. 9(5) MCD were introduced only by GEO 15/2024. According to the new Art. 88^2, when a creditor or a credit intermediary from another Member State provides credit services in Romanian territory, it must comply with the minimum requirements of its country of origin concerning knowledge and competencies. Similarly, the new Art. 88^1 provides minimum requirements for Romanian creditors and intermediaries providing services in other Member States, imposing the fulfilment of minimum requirements for knowledge and competencies of the staff of a branch provided for in Annex 3 to GEO 52/2016. However, this provision does not consider that the needs of consumers and other market conditions may significantly differ in Romania from those of other EU Member States. This provision rather aims to grant the freedom to provide services for credit institutions and credit intermediaries than enhanced consumer protection. Abuses are committed not because of lack of knowledge and competences of the foreign credit institutions and credit intermediaries acting on the Romanian market, but because of the weak market surveillance.

Art. 113 GEO 52/2016 provides only for the information of the competent authorities of the home country of the credit intermediary, which will take the necessary measures, if the NACP establishes, based on clear evidence, that a credit intermediary of another Member State providing credit services in Romania infringes the provisions of GEO 52/2016. The measures are fully at the discretion of the home country of the infringer.

Art. 107(1) introduced to GEO 52/2016 by GEO 15/2024 enhances transparency in the host market by stipulating that those credit intermediaries that are registered in Romania and provide intermediary services for the first time in the EU or within the EEA, based on freedom of services, or as an agency, must inform the NACP about such activity and the competent foreign authority will provide the necessary data to the NACP so that it registers credit intermediaries that provide for the first time in Romania.

Additional definitions and provisions were also introduced in GEO 52/2016 in this context. Art. 3(20) defined the concept of host Member State –missing before from the text of GEO 52/2016– as the Member State other than the Member State of origin in which the creditor or its intermediary has a branch or provides services. Another concept introduced in 2024 is that of the immovable developer. According to Art. 3(36) this may be a legal person or a natural person authorised by law who provides activities related to immovables aimed at construction, finalisation and delivery of homes to beneficiaries as well as the coordination of financial sources necessary for such investments.

4 Review of GEO 52/2016 by the Romanian Constitutional Court

The assignment of loans to non-banking entities outside Romania continued also after the enactment of GEO 52/2016 and the Romanian case law continued to be conflicting during the following years. This is why in July 2020 the issue landed on the agenda of the Constitutional Court. In its Decision of 25 June 2020[16] the Constitutional Court

[16] Decision no. 500 of June 25, 2020 of the Constitutional Court (DECIZIA referitoare la excepția de neconstituționalitate a dispozițiilor art. 135 alin. (1) raportat la art. 58 alin. (5) din Ordonanța de urgență a Guvernului nr. 52/2016 privind contractele de credit oferite consumatorilor pentru bunuri imobile, precum şi pentru modificarea şi completarea Ordonanței de urgență a Guvernului nr. 50/2010 privind contractele de credit pentru consumatori).

came to the conclusion that the loan agreement is an enforcement title, and the annulment of an enforcement title may be done only when an amending legislation allows it; i.e. GEO 52/2016 applies only to agreements concluded after the entering into force of the new provisions on mortgage loans, not affecting existing agreements.[17]

This in the court's view applies also to loan agreements assigned to debt collecting entities. However, for consumer protection reasons, the court does not consider a loan agreement assigned by the original creditor to a debt collecting commercial entity an enforcement title.[18] In the court's reasoning, GEO 52/2016 protects the consumers, granting priority to the interest of consumers, who become vulnerable vis-à-vis the assignees that are debt collecting companies.[19] Therefore the assignee, the debt collecting company, will have to obtain in court an enforcement title before enforcing the loan agreement.[20] Nevertheless, the court considered that the application of this approach to existing contracts assigned to debt collecting companies before the entry into force of GEO 52/2016 would infringe the principle of non-retroactivity of the law and would harm legal certainty and for this reason the temporal scope of application of the GEO 52/2016 cannot be extended to agreements assigned to debt collecting companies before its entering into force.[21]

Furthermore, the court also clarified that although GEO 52/2016 is the implementing law of the MCD, Art. 135 (1) in connection to Art. 58(5) GEO 52/2016 does not constitute implementation of the MCD, thus by not applying these provisions to contracts assigned before to debt collecting commercial companies, it uses to same concept as the EU Directive.[22] The Constitutional Court further established that the challenged provisions do not infringe the Romanian Constitution and declared that they are in line with the scope and letter of the MCD concerning its temporal application, meaning that contracts concluded before 2016 do not fall under the Directive

By this constitutional court decision, the victims of past assignments to non-banking entities remained again without protection. It is worth mentioning that five major

[17]Decision no. 500 of June 25, 2020 of the Constitutional Court Decision no. 500 of June 25, 2020 of the Constitutional Court, para. 40.

[18] Decision no. 500 of June 25, 2020 of the Constitutional Court, para. 47.

[19] Decision no. 500 of June 25, 2020 of the Constitutional Court, para. 47.

[20] Decision no. 500 of June 25, 2020 of the Constitutional Court, para. 48.

[21]Decision no. 500 of June 25, 2020 of the Constitutional Court, para. 49.

[22] Decision no. 500 of June 25, 2020 of the Constitutional Court, para. 59.

banks acting in the Romanian market were involved in this case, including B.R.D.-Groupe Société Générale S.A., Raiffeisen Bank S.A., Banca Comercială Română S.A.

It has become a common practice in Romania that in the field of legislation concerning consumer loan agreements, including mortgage loans, a switch in roles in the Romanian judicial system takes place, meaning that the Constitutional Court takes the lead in clarifying issues related to the application and implementation of private law legislation concerning contracts.[23] This tool is pursued by the financial sector often requesting constitutional control on consumer protection legislation when it feels threatened in its contractual freedom in the Romanian market.

IV Problems in Search for Solutions in the Romanian Market of Consumer Loans

1 Assignment of Loans to Non-Commercial Entities Outside Romania

The saga of loan assignments falling out of mortgage loan legislation started in 2014 with a Supreme Court decision, when the Înalta Curte de Casație și Justiție (ÎCCJ) clarified that securing a loan by a mortgage in case of purchase of an immovable for personal use does not transform such a loan agreement into a mortgage loan, since for this both of the two following conditions laid down by Law 190/1999 must be fulfilled: a) the repayment of the loan must be secured with a mortgage and b) the object of the loan agreement must be an immovable investment.[24]

The case concerned the annulment action submitted by a consumer related to a loan denominated in foreign currency, assigned to a debt collecting commercial entity. The highest court argued that by failing to fulfil the two conditions mentioned above, the loan agreement does not fall under Art. 24-28 Law 190/1999 on mortgage loans imposing that the assignee must be a banking institution, but under the general provisions of the Civil Code. Due to this interpretation many courts issued decisions confirming the validity of the assignment and ignoring that, as a result, the consumer remained outside of the reach of the consumer protection granted under the mortgage loan legislation, especially when such commercial entities were located outside the EU.

The activity of credit intermediaries falls under GEO 52/2016 and theoretically from 2017 onwards such entities must have complied with the rules it provides. In 2018 the NACP investigated, based on mass media information and complaints from territorial consumer protection authorities, the legality of activities conducted by two credit institutions providing services directly in the Romanian market from other Member States.

[23] More details on judicial governance by consumer private law, Józon (2020).

[24] *Decision no. 1671 of May 14, 2014, Civil Section II, High Court of Cassation and Justice.*

During 2008-2015 Bancpost assigned 63,000 foreign currency loan agreements to foreign non-banking companies. These transactions amounted more than EUR 675,000,000 worth performing loans, for which Romanian consumers were charged subsequently more than EUR 300,000,000. Consumers were not informed previously about the assignments, but only later when they were invited to sign contract amendments to the initial loan agreement. Bancpost assigned these loan agreements to EFG New Europe Funding II B.V., a Dutch commercial entity that was not authorised to conduct such activates neither in Romania nor in The Netherlands. The EFG restructured the loans and converted them, these activities being considered by the consumer protection authority as crediting activities.[25] The loan agreements referred to the reference index of the bank in case of variable interest rates, whereas the assigned entity was not a bank and in addition the assignee charged penalties for the whole amount in case of early repayment. EFG also charged a management fee of at least 0.1% on the value of the entire balance, although it did not service the loan, which continued to be done by Bancpost.[26]

After the entering into force of GEO 50/2010 on consumer loan agreements, EFG issued additional changes to the loan agreement mentioning and qualifying itself as the creditor, although they did not fall under the definition of creditor set by GEO 50/2010.

Starting from 2018 the loans assigned to EFG New Europe were transferred to European Erases in Greece, before Bancpost was purchased by another Romanian bank, Banca Transylvania.

The NACP fined Bancpost with RON 150,000 (equivalent of EUR 30,000) for the infringement of GO 21/1991 on consumer protection law and for the use of unfair commercial practices under Law 363/2007 because the performing loans were assigned to a limited liability company in Greece owned by the EFG group, to which Bancpost belonged before being acquired by the Banca Transylvania. In addition, the NACP ordered the bank to reimburse to the concerned clients the money they overpaid as a result of the assignment of their loans to legal entities located outside Romania directly or through the intermediary entity during the period of 11 July 2008 to 27 March 2018.

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[25] See https://www.profit.ro/stiri/exclusiv-document-cjpc-constanta-sanctionat-bancpost-cesiunea-creditelor-olanda-dispune-restituirea-dobanzilor-platite-consumatori-functionar-avertizeaza-daunele-suferite-consumatori-depasesc-300-18335063

[26] See https://www.profit.ro/stiri/exclusiv-document-cjpc-constanta-sanctionat-bancpost-cesiunea-creditelor-olanda-dispune-restituirea-dobanzilor-platite-consumatori-functionar-avertizeaza-daunele-suferite-consumatori-depasesc-300-18335063

However, later on the NACP lost the case before the administrative court on the grounds that Banca Transylvania could not be held liable for the acts of third persons, the assignee, since this would infringe the principle of personal nature of administrative liability. The Tribunal of Bucharest rejected NACP's claim due to late submission and because when the assignments took place the law did not prevent the assignment of foreign currency loans to foreign entities, which fall outside Romanian jurisdiction.

Although by assigning performing loans to non-financial or banking entities Bancpost infringed Law 190/1990 Art. 24(1), because assignment was allowed only to entities of the same type or authorised entities, the Romanian consumers remained deprived of protection in such situation because under Government Decision 700/2012 the Romanian NACP has no competence to impose fines against assignees, commercial companies of banks that implement loan agreements. The European Consumer Centre Romania also cannot impose fines against entities located outside Romania for infringement of the national legislation and cannot order repayment of the money charged from the Romanian consumers. Government Ordinance 2/2001 on administrative sanctions is not clear on the legal consequences of infringements committed against Romanians by legal entities registered outside Romania.

The case of the Romanian victims of these transactions is further complicated also by the temporal effects of GEO 52/2016, which does not apply to loan agreements under implementation concluded before its entering into force, as confirmed by the Romanian Constitutional Court in its decision no. 500 of June 25, 2020, presented above.

2 Same Contract Terms Applied by 19 Banks on Reimbursement of Loans. Misleading Commercial Practices? Concerted Practices of Banks?

Although GEO 52/2026 and its 2024 amendments provide restrictions on how banks may establish the interest rates, misleading practices continue in the Romanian market, this being clear evidence of low effectiveness of the legislation. A recent case of infringement appeared in the media in 2023. It involved nineteen banks acting in the Romanian market, which applied the same contract terms on reimbursement of the loans. Initially, according to the press release of the NACP, eleven banks (ING Bank, First Bank, Credite Europe Bank, OTP Bank, Alpha Bank, BancaTransilvania, Raiffeisen Bank, BCR, Patria Bank, Unicredit Bank, BRD Groupe Societe Generale) were investigated and sanctioned.[27] Shortly after, in May 2023, another eight banks (EXIM Bank, Procredit Bank, Intesa Sanpaolo, Techventures Bank, Libra Bank, CEC

[27] See ANPC sancționează 11 bănci din România (2023). Available at: https://anpc.ro/anpc-sanctioneaza-11-banci-din-romania/

Bank, Garanti Bank, Vista Bank) were investigated by the NACP for the similar contracting practice.[28]

The NACP found, under Law 363/2007, which is the implementing legislation of the EU Directive on misleading commercial practices, that these banks established the loan reimbursement instalments in a misleading manner, since during the first years of the loan agreement instalments comprised 25% principal and 75% interest. Therefore, consumers paid mostly interest and not the principal. As result of the investigation, all eleven banks were fined to RON 500,000 each and were compelled to reschedule reimbursement charts with the consumers providing for equal rates for the whole lending period. In the case of the second investigation concerning the other 8 banks, to restore contractual equilibrium between the parties the NACP ordered, besides the administrative sanction of 400.000 RON for each of the 8 banks, as well as the issuance of new reimbursement charts for loans in implementation and for future contracts in equal rates for the whole lending period. In the view of the NACP, such solutions were needed for the consumer to be able to foresee any misleading costs of method of calculation. However, the NACP lost on appeal so far seven of these cases.[29]

The reason why these cases were lost is that they were filed later than six months from the time when the contract was concluded. These consumers may go to civil law courts and try challenging the terms under the implementing law on unfair contract terms, but market regulation fails do its job because of procedural rules and procedural autonomy of a Member State. This entails that consumers are vulnerable also in procedural law terms.[30]

It is even more absurd that there is no debate in the Romanian legal literature or in the economic literature about the market impacts of what seems to be concerted practice among competitors.

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[28] See https://financialintelligence.ro/anpc-sanctioneaza-alte-8-banci-din-romania-amenzi-de-400-000-lei-anpc-propune-emiterea-unor-noi-grafice-de-rambursare-pentru-creditele-aflate (March 2023).

[29] See ANPC pierde definitiv primul dintre cele 19 procese cu băncile amendate pentru că ar fi înșelat clienții prin modul de calculare a ratelor (2024) Available at: https://ziare.com/banci-amendate-anpc/proces-pierdut-inselare-clienti-calculare-rate-1880855

[30] On the proceduralisation of consumer private law to the detriment of material justice see, Józon (2017).

V Lessons for the Future

From a ‘law in action’ perspective on the transposition of the MCD in Romania and its subsequent amendments, one may conclude in light of information on past and recent law infringements that the patchwork perspective of reacting to acute regulatory needs only when pressure comes from the EU is not granting an effective protection to the Romanian consumers in the mortgage loans market. Such reactive, instead of proactive, attitude of the Romanian legislator, is not able to drive market behaviour in a more pro-consumer direction. The MCD would have allowed from the very beginning the enactment of stricter rules when necessary.

It looks like it is cheaper and safer for credit institutions to infringe or to avoid the law than to comply with it, since pecuniary sanctions are ridiculously low in the Romanian market and the enforcement capacity of the authorities is ineffective. However, there is not yet information available on the effectiveness of the complementary sanctions introduced in spring 2024 that may seriously affect and even prohibit the activity of the credit institutions if they infringe the mortgage loan legislation.

As long as sanctions and damages are left to Member States’ discretion there will always be regulatory competition and race to the bottom in certain Member States that distort competition to the detriment of consumer protection. Because mortgage loan services may be freely provided cross border, consumers with a lower or less effective consumer protection market surveillance or ineffective judicial enforcement, will always be disadvantaged and will remain with weak protection in such countries.

The approach of the Romanian legislator to include into the text of the implementing law of the MCD specific provisions complementing the legislation on unfair contract terms and unfair commercial practices are signs that it has acknowledged that these fields strongly interact and therefore need a unitary or at least complementary approach in regulation. By this it acknowledges the weakness of private law tools to enhance the protection of the economic interests of the consumers of mortgage loans. Such rules indeed must be enhanced in the future by public law regulation at EU level as well. However, at the time of drafting this chapter no cases can be reported yet on the enforcement of such measures.

The case of Romania illustrates well that the balance between private law and public law (market regulations) should be reconsidered at EU level in the field of mortgage loans. Too much weight and too relevant a role is devoted to private law tools in hands of consumers, who are the weaker party compared to banks or other commercial entities involved in loan management, instead of stricter rules on market surveillance. More risk allocation to banks would be needed, because it looks like for banks it continues worth infringing domestic legislation rooted in EU legislation in terms of costs and benefits in certain countries like Romania, than complying with EU legislation.

Under the impact of MCD and EU pilot procedures for late or defective implementation of MCD the Romanian legal framework will be sooner or later adjusted to the requirements of the EU Law. However, decades have passed since the global financial crisis of 2008 created a favourable market environment for abuses by banks against consumers, and the inheritance of the past, when there were no proper legal rules and no proper market surveillance in place, remains unsolved both at EU and national level by newly issued legislation. These externalities of financial inclusion of consumers and freedom of provision of banking services EU wide continue to be rolled ahead, causing immense losses to the Romanian consumers.

Mortgage loan agreements are long term contracts concluded for thirty years or longer; the impact on consumers and their families of the abusive contracting and marketing practices of the banks is long term as well. Progress made by EU legislation in enhancing more responsible lending and borrowing applies as a rule only to loan agreements concluded upon the entering into force of the new legislation and the consumers who are victims of past abuses, when no proper EU legislation was in place or when EU legislation was implemented with delay, or transposed or enforced defectively at Member State level, do not benefit from the new legislation. These consumers are extremely vulnerable, therefore they should be treated as vulnerable consumers under enhanced protection, by legislation suited to their specific situation aimed to resolve past abuses.

The principle of non-retroactivity of laws needs to be refined in case of long-term contracts concluded under the effect of past regulations and laws, while the markets bring to surface several stringent new regulatory needs in the field of consumer protection that did not exist at the time of contract conclusion, such regulatory needs being the products of contract implementation and enforcement. Although the CJEU has clarified, concerning the temporal application of EU consumer legislation in the field of consumer finances that it is up to the Member States to extend the application of EU legislation to consumer loan agreements not falling under their temporal scope of application,[31] and this was acknowledged also by the Romanian Constitutional Court,[32] the Romanian legislator and judiciary does not make use of this possibility in order to enhance consumer protection. So, consumers remain outside of the reach of recent legislation, at the discretion of banks, financial intermediaries or debt collecting companies, which continue to search for new techniques to avoid liability risk and liability costs in the Romanian market of mortgage loans.

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[31] CJEU 12 July 2012, *ANPC Călărași* v *Volksbank Romania S.A.*, Case C- 602/10 (EU:C: 2012:443) concerning the temporal effect of Directive 2008/38/EU.

[32] Decision no. 500 of June 25, 2020 of the Romanian Constitutional Court, para. 17.

Most problems consumers face in mortgage loan agreements arise during implementation and enforcement of long-term contracts, while the approach of the MCD, except for a few provisions, continues to concentrate on pre-contractual information and contract conclusion. More rules on contract implementation are desired in future amendments to the MCD. The few measures introduced in Romania, presented in Section III, may be considered also at EU level.

Weak or defective enforcement of EU consumer finance legislation, including mortgage loans, has also to do to a certain extent with the approach of the EU directives, these being framed by principle-based rules that need further detail and often certain complementary voluntary legislative measures to make such provisions fully functional in the context of domestic private law. In countries like Romania where financial consumer protection policy is constantly overridden by other economic and political interests and where for this reason consumer protection measures are kept at minimum and subsequent legislative actions making the EU rooted law functional and effective are delayed or later sabotaged by the financial sector, the principles-driven approach does not drive to the expected results. A different approach in legislative drafting should be considered, because the same problem exists also in case of other pieces of EU consumer legislation, for example concerning Directive 93/13 on unfair contract terms in consumer contracts.[33] Such type of directives provide too large room to Member States and if the Member State misses this opportunity then the judiciary has to solve this situation and assume the role of market policing.

In Romania consumer policy has not evolved into a horizontal policy as the EU policy and law envisaged, but is always strongly debated and weighted against other economic policies and political interests. In this balancing exercise justice provision to consumers is usually lost among issues of wealth distributions/redistribution, social justice, freedom of economy, right to property and other considerations that exceed the field of consumer mortgage loan and justice provision between the financial institution and the individual consumer.

In light of the Romanian experience, that may not be unique in the EU, the wealth redistribution impact of EU mortgage loan legislation needs to be considered and debated at EU level. Today this is mostly left to courts, to the judiciary of the Member States, the final policy-maker in such matters being the ECJ with its preliminary rulings. Free provision of credit services within the EU produces negative externalities, such as consumer over-indebtedness, that needs European solutions. Wealth distribution/redistribution related to consumer finances need to be advanced into a hard-core policy in search for European solutions.[34]

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[33] Józon (2017).

[34] Critically on the lacking social justice perspective of EU consumer finance law see, Fejős (2018).

Not fixing the regulatory needs with suitable legal solutions also deeply impacts the regulatory governance at Member State level, causing switches in roles within the judiciary and changes in roles in the relation of legislative and the judiciary in search for solutions.[35] Both in mortgage loan law and unfair contract terms law the Romanian Constitutional Court assumed in the past, and continues to do so, the role of private law courts and provides private law justice, which is abnormal. In a Constitutional Court case the issue at stake loses its private law dimension and its individual justice dimension and turns into a debate about more general values that are weighted against each other. Moreover, once the Constitutional Court delivers its opinion, there remains no room for a different outcome for private justice. Faced with such development in Romania, the highest court (ÎCCJ) seems to minimise its role, which is taken over by the Constitutional Court, the latter becoming the policy maker in private law matters. This process is the outcome of a situation where civil law courts were put constantly in the position of having to rule on social justice issues and by doing so to take position in issues of wealth distribution. This should not be the task of the judiciary, of the civil law courts nor of the Constitutional Court, but needs to be enshrined in legislation at the EU level considering the externalities of freedom to provide cross-border financial services on the Internal Market of the EU. Policy issues are no longer solved by EU legislative amendments preceded by political decisions taken by Member State governments at EU level, but via judicial cooperation, and this raises issues of democratic legitimacy within the EU.

The case of Romania showcases the need for, and strongly pleads for, effective private international rules in EU legislation on mortgage loans. This is required because mostly foreign banks, located in other EU Member States, market defective products, use unfair contract terms, mislead consumers with unfair commercial practices, including assignment of performing loans to non-banking entities outside Romania, who are not registered and accredited to conduct such activities in Romania and therefore fall outside the control of the Romanian market surveillance authorities. Such practices are not allowed in their home countries due to better market regulations and better market surveillance. For this reason, the home country control does not provide proper tools against abuses committed in host country markets. On the other hand, as long as there is race to the bottom allowed under the EU regulatory policy lower consumer protection level in certain Member States is accepted by law, and Romania is definitely among these countries where the host country control remains ineffective.

It looks like the legislation remains always steps behind the market practices and this puts obstacles to consumer protection. Solution-finding at EU and at national level therefore needs an innovative approach from scholars and policy decision makers,

[35] More on private law governance in the field of consumer finances: Józon (2020).

that implies the stepping out from the patterns of current consumer policy at EU level, based on information and choice related to contract conclusion. If assessed from this point of view, the MCD as it stands today clearly follows the old pattern: responsibility and liability is mostly put on the consumers, who are active, well-informed, circumspect market players. This is not the case considering their high vulnerability in the financial market, especially in case of mortgage loans.

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CHAPTER 13

REVIEW OF THE MORTGAGE CREDIT DIRECTIVE FROM THE SPANISH EXPERIENCE

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I. Introduction

It has been ten years since the approval of the MCD, which was transposed into Spanish law by L 5/2019, 15 March, on immovable property credit agreements (LCCI), developed by RD 309/2019, 26 April, and by Ministerial Order ECE/482/2019 of the same date. Neither the Directive nor the transposition met expectations and were seen as a missed opportunity by the Spanish academia. However, the passage of time has revealed the rights and wrongs of both regulations and allows to assess now the extent to which their solutions have contributed to remedy the problems that mortgage contracts were causing in Spanish practice. It is also time to question whether these rules should be updated to meet the new challenges that have arisen.

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It is common knowledge that Spain is characterised by a widespread and deep-rooted culture of property ownership,[1] where mortgage financing allows a very high percentage of individuals to have access to such a basic asset as a home.[2]

In this sense, and despite the existence of recent public policies apparently focused on promoting affordable rent[3] and some alternatives to home ownership,[4] the latter plays a leading role in the Spanish property market and its entry point is, more often than not, mortgage financing.[5]

The devastating effects that the 2008 economic crisis unleashed on Spanish households are also well known,[6] with an exponential increase in mortgage enforcements,[7] which has led to some restructuring measures. However, the belated reaction of the Spanish legislator, which did not begin until 2011,[8] encouraged the

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[1] According to the Population and Housing Survey 2021 (INE), complemented by the Survey of Essential Population and Housing Characteristics (ECEPOV) of 2021, 75.2% of Spanish households owned their home in 2021, although the percentage has decreased compared to that observed ten years earlier (78.9%), due to the increase in the percentage of rented housing, which has grown from 13.5% to 15.9%.

[2] The Spanish Association of Registrars' report for the last quarter of 2023 shows that the number of sales and purchases with mortgage financing is 69.2%, compared to 30.8% that are not secured by a mortgage: Centro de Procesos Estadísticos 2023 (https://www.registradores.org/actualidad/portal-estadistico-registral/estadisticas-de-propiedad) 59.

[3] The recently approved L 12/2023, 24 May, on the Right to Housing, tries to increase the supply of housing at affordable prices by containing the rise in rental prices or directly limiting them in areas with a stressed residential market. However, as expressed in its Preamble, policies began to be reoriented towards rehabilitation and renting in 2009.

[4] For example, shared and temporary ownership in the Catalan Civil Code: see Caballé Fabra (2018).

[5] In the first quarter of 2024, of the total of 42.478 mortgages created, 41.712 were on urban properties, of which 33.128 were dwellings (https://www.ine.es/jaxiT3/Datos.htm?t=13896), which shows that the main purpose of mortgage loans continues to be the acquisition of housing, followed by second homes.

[6] On the causes of the crisis and its repercussions in Spain, see Anderson & Simón (2017) 50-55.

[7] Mortgage loans concluded between 2005 and 2008 account for the highest percentage of mortgage enforcement proceedings initiated in the last ten years, according to the INE's Mortgage Enforcement Statistics. Thus, for example, 61.6% of proceedings initiated in 2014 corresponded to mortgage agreements concluded during said period (https://www.ine.es/daco/daco42/eh/eh0414.pdf) and 49.8% of enforcement proceedings in 2023 correspond to mortgage agreements concluded in 2005-2008 (https://www.ine.es/dyngs/Prensa/EH4T23.htm).

[8] As Anderson & Simón (2017) 54 point out, on the eve of the international economic crisis, Law 41/2007, 7 December was passed, which far from providing for any measure that could counteract the looming crisis, encouraged contracting through new mortgage products of uncertain contours, such as the reverse mortgage and the floating mortgage.

intervention of some courts that, doing justice to the case, distorted legal principles in order to alleviate the situation of Spanish families, by failing to apply, for example, the principle whereby all the debtor's assets, and not only the mortgaged property, are subject to claims in the event of default (Art. 1911 CC) or forcing *datio in solutum*, under the most varied arguments: equity, the doctrine of abuse of rights, unjust enrichment, human and fundamental rights, etc.[9] In this same context, a problem of major dimensions came to the surface: the courts found a marked lack of transparency in mortgage contracts, which has flooded the national and supranational courts of justice (markedly, the ECJ) with proceedings in which the abusiveness, and consequent nullity, of a multiplicity of clauses, is being questioned (interest rate floors, late-payment interest, remunerative interest referenced to questionable indices, costs associated with mortgage contracts, acceleration clauses, arrangement fee clauses and a long etcetera).

Given the content of the MCD and its transposition into Spanish law, and considering the problems that have arisen in Spanish practice and the peculiarities of its mortgage system, some aspects could be improved in each of the three pillars on which the regulation revolves —or should revolve: i) the scope of application of the solutions enshrined in the regulation; ii) the measures that seek to promote responsible and transparent lending; and iii) the remedies in case of the debtor's default.

II. Scope of Application of the MCD: The Fragmented Regulation It Enables

Any study of the MCD involves paying attention to its intricate scope of application, which devotes an extensive Art. 3 to elucidating which types of contracts it applies to, which it does not apply to, and those where the decision is left to each of the Member States. The LCCI makes use of this power and extends the subjective and objective scope of application. However, the regulatory framework is extremely complex and requires a distinction to be made between cases that, due to their close similarity, should be subject to the same regime, which undoubtedly reduces its efficiency.[10]

Thus, while the Directive applies to credit agreements secured by a mortgage or other comparable security over a residential property when the borrower is a consumer, the LCCI extends the scope of the provision, as a general rule (with some exceptions: Art. 2(1)(b), to all natural persons, even if they are not consumers and regardless as to whether they are borrowers or guarantors.[11] Similarly, the Spanish regulation

[9] Anderson & Simón (2017) 55; for a detailed analysis see Nasarre-Aznar (2015), 127-147.

[10] Anderson (2019) 13.

[11] Although the Directive does not expressly exclude real or personal guarantors, it stipulates that its provisions apply to credit agreements 'concluded' by consumers, from which it follows that the former are excluded, insofar as it is the borrower who 'contracts': Agüero Ortiz (2019) 107.

broadens the concept of creditor to include not only those who grant credit in the exercise of their commercial or professional activity (Art. 4(2) MCD) but also those who occasionally intervene in the market exclusively as an investment (Art. 2(1) *in fine* LCCI).

From the objective point of view, the LCCI incorporates, together with 'residential immovable property' (Art. 3(1)(a) MCD), other immovable assets that may fulfil a 'domestic function', such as storage rooms and garages (Art. 2(1)(a) LCCI); and it also provides for a broader transitional regime than the Directive, as it orders the application of some of its provisions to contracts concluded before it entered into force and, of course, to those that are subject to modification or novation (transitional provision 1 LCCI).

1 Subjective Scope: The Borrower-Guarantor (Consumer or Not) And the Lender-Intermediary (Professional or Not)

The extension of the LCCI to include every natural person, whether they are consumers or not, is to be welcomed. However, the resulting framework is imprecise, uncertain, and unjustifiably heterogeneous. Namely, the LCCI applies to loans or credits in which an individual acts as borrower or guarantor and which are secured by a mortgage on a residential property, regardless of the purpose of the loan (medical expenses, travel, professional expenses, etc.),[12] so that it would extend, for example, to the director of the company acting as guarantor of a loan for commercial purposes, if it is secured by residential property. By contrast, it would not apply if the loan were intended for the purchase of a residential property and is secured by a mortgage on a property that is not residential.[13]

Moreover, the LCCI requires the borrower or guarantor to act as a consumer when the loan is taken out to acquire or retain property rights in land or in an existing or projected building (Art. 2(1)(b)), even if no mortgage is constituted as security. So, the self-employed worker, who would be protected when applying for a loan secured by a residential property in the context of his or her profession, is left out if the collateral is a plot of land or a property under construction, even though the risks undertaken are similar.[14] It is also surprising that a loan secured by a mortgage on a parking space to a non-consumer natural person is subject to the LCCI, while the acquisition of a home by a legal person (e.g. a foundation with social purposes that is going to use it for the temporary shelter of people) is not, if the mortgage does not encumber a

[12] Agüero Ortiz (2019) 118; Hidalgo García (2021) 104.

[13] Anderson (2019) 14.

[14] Anderson (2019) 13.

residential property, but a separate non-residential immovable.[15] That is, of course, provided that a consumer is understood to be a 'natural person who […] is acting for purposes which are outside his trade, business or profession' (Art. 3(a) CCD 2008, which Art. 4(1) MCD refers to). In fact, although Art. 3 of the General Law for the Protection of Consumers and Users (TRLGDCU) includes legal persons and entities without legal personality that act on a not-for-profit basis, the LCCI emphasises that it applies to 'natural persons' (Arts 1 and 2(1)), so who are not considered as such should be excluded.[16] It is something that perhaps the Spanish legislator should reconsider, if the aim is to extend protection to those who are considered vulnerable contracting parties vis-à-vis professional ones.

In any case, when the application of the LCCI is determined by the presence of a guarantor, it is not clear whether its rules apply to the underlying loan and to the borrower (legal person or non-consumer) or just to the guarantor. The Spanish Directorate-General for Registries and Notaries has decided to apply it only to guarantors (Instruction of 20 December 2019), with the paradox that they will receive a large amount of information in contrast to that provided to the debtor who has the status of a legal person.[17] Hence, it would be advisable for the Spanish legislator to make a clear statement and avoid the aforementioned inconsistencies.

As regards the active position of the loan contract, the MCD applies to lenders and credit intermediaries but also to anyone who intervenes in the financial services market 'even occasionally, with an exclusive investment purpose'; that is, as long as they get a profit for the capital loaned,[18] even if they are not professionally engaged in granting credit; this could even include consumers, according to Case C-208/18, *Jana Petruchová* v. *FIBO Group Holdings Limited* [2019]. So, they will be subject to the same requirements as a professional lender, which they will find difficult to meet.

Finally, it is questioned whether immovable property loans granted by investors through crowdfunding platforms would fall within the scope of the law.[19] This is undoubtedly one of the concerns of the European Commission, due to their increasing activity; especially in times of crisis when alternative financing may become the last resort for many citizens or small businesses who have no access to traditional banking.[20] Moreover, in the case of immovable property projects financed through

[15] Hidalgo García (2021) 296.

[16] Agüero Ortiz (2019) 128-129.

[17] Cabanas Trejo (2020) 88-92.

[18] Agüero Ortiz (2019) 115.

[19] Díez Soto (2023) 337.

[20] Cuena Casas (2020) 371.

loans, it is easy for mortgage guarantees to be granted on the property being acquired, especially taking into account that Law 18/2022, 28 September, on the creation and growth of companies, has eliminated the provision contained in Law 5/2015, 27 April, which prohibited consumers from creating a mortgage (Art. 87 in relation to Art. 49(a)), as well as the individual entrepreneur from mortgaging his or her habitual residence (Art. 74(2)). With these norms repealed, that possibility opens up.

2 Objective Scope: Lack of Definition and Exclusions

The Spanish regulation picks up the same blurry terminology used by the Directive regarding the characteristics that the mortgaged property must meet, that is, being 'for residential use' or fulfilling 'a domestic function' (Art. 2(1)(a) LCCI), without providing specification as to what this means. Furthermore, both the MCD and the LCCI require clarification as to what is meant by credit agreements whose purpose is to acquire or 'retain' property rights in land or in an existing or projected building, because the dividing line between 'retaining' and 'renovating' is by no means clear-cut.[21]

Apart from those interpretative questions, another problem to solve is the exclusion of some specific hypotheses from the scope of the law: on the one hand, the reverse mortgage,[22] an instrument designed for people in vulnerable situations due to their age or disability who deserve the same protection, if not more, in terms of information and transparency procedures, and whose exclusion has led to regulatory duplication;[23] on the other hand, loans granted by employers to their employees on a discounted rate and those without interest or charges, as contracting on favourable terms is not incompatible with transparency or responsible lending.[24]

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[21] See Instruction of 20 December 2019 of the Directorate-General for Registries and Notaries.

[22] Prats Albentosa (2020) 23 warns that the expression used by the MCD is the result of a defective translation into Spanish of the locution 'equity release credit agreements', which includes a set of financing contracts that go beyond our reverse mortgage.

[23] Anderson (2016) 53; Agüero Ortiz (2019) 155-157; Tenza Llorente (2022) 257-260; Cordero Lobato (2019) 80 and 189: it is striking that, on this point, the MCD does not even recommend to States that these debtors have 'an adequate framework' of transparency, as it does for other possible exclusions.

[24] Anderson & Simón (2017) 73; Cabanas Trejo (2020) 119-120.

III Responsible and Transparent Lending

1 The Contracting Process: Areas for Improvement and Future Challenges

If there is one issue of particular concern in the Spanish immovable property credit market, it is the information provided to the contracting party before and during the contract formation stage, the deficient provision of which has led to a flood of legal proceedings that have called into question the activity of financial institutions. This was a fundamental aspect of mortgage contracting that urgently needed to be resolved in order to restore legal certainty after a decade of unpredictability surrounding Spanish mortgages.

The situation experienced in this country has not been the result, in any case, of the absence of detailed information obligations, which have been very present since 1989.[25] However, as the Supreme Court (SC) has pointed out, mere compliance with the information obligations laid down in the regulations is not synonymous with transparency,[26] nor is the abundance of information if it does not lead to real understanding by the consumer.[27] Equally, the obligation to provide the customer with pre-contractual information, must mean 'something more' than just allowing him or her to review the draft public deed before signing the contract.[28]

However, the MCD and, with it, the LCCI, go further in the same direction: that of the standardisation and overabundance of information to be provided to the customer at the different stages of the contracting process.[29] Thus, up to three stages are contemplated: the basic one that must appear in advertising, the general one and the pre-contractual information instrumented through the ESIS; all this together with a final rule about the need to provide 'adequate explanations' for all the above. It would be desirable, by the way, to establish the means to prove that the explanations provided were adequate[30] and to set up an effective system for monitoring compliance.[31] In any case, this last provision shows the weakness of the information

[25] The Order of 12 December 1989 was followed by the Order 5 May 1994, Law 2/2009, 31 March, and Order EHA/2899/2011, 28 October.

[26] SC decisions 1 February 2018 (ECLI:ES:TS:2018:219); 14 March 2019 (ECLI:ES:TS:2019:773); 29 November 2021 (ECLI:ES:TS:2021:4376); 20 September 2022 (ECLI:ES:TS:2022:3391).

[27] SC decisions 8 June 2017 (ECLI:ES:TS:2017:2244), 1 February 2018 (ECLI:ES:TS:2018:219); 11 April 2018 (ECLI:ES:TS:2018:1315).

[28] SC decision 29 January 2018 (ECLI:ES:TS:2018:182).

[29] Cordero Lobato (2019) 177; Muñiz Espada (2020) 45.

[30] Cordero Lobato (2019) 185; Marín López (2019) 304 ff.

[31] Prats Albentosa (2020) 158.

regime designed: the mere provision of information, however standardised and clearly presented, may be insufficient if adequate explanations are not provided. Moreover, even this does not guarantee that the consumer truly understands the explanations or can adequately weigh up the risks and prevent a lack of balance when it is natural that, with the incentive of acquiring the asset (particularly a home), there is a tendency to ignore the complexities and disregard the possible setbacks that may arise over the long life of the loan (loss of employment, family crises, illness, etc.) which could lead to insolvency.[32]

Of course, the commitment to a standardised information model has positive aspects, such as the ease of comparing different offers. However, this system does not exclude (nor would a model loan contract: final provision 15(1)(a) LCCI) the transparency controls, although that is the objective in Spain.[33] This is well illustrated by past experience, where, despite opting for a standardised model for providing information, the judge has been able to assess whether the contractual process has been sufficiently transparent, although for the moment it may have helped alleviate litigation.[34] It should be noted, indeed, that the text with which the ESIS is completed is not entirely predefined, as it happens with 'Other obligations' (point 8) or the conditions for early repayment (point 9), clauses which may have particular relevance for the economy of the contract.[35]

In the field of the information to be provided, the law must make explicit the need to inform the guarantors of the risks specifically involved in the provision of the guarantee, including the possibility of losing ownership in the event of default.[36] Indeed, this area needs legal certainty in the Spanish market, where there has been a proliferation of proceedings questioning whether or not the contracting process of the ancillary guarantee passes the transparency control.[37]

[32] Arroyo Amayuelas (2017) 24; Cordero Lobato (2019) 184; Cuena Casas (2019) 273.

[33] See the criticism made by Pasquau Liaño (2020) 56 ff.

[34] See statistics from the General Council of the Judiciary in relation to the claims presented, whose trend is clearly downward, from 202,787 in 2018 to 88,622 in 2023, although it may also be due to other factors: https://www.poderjudicial.es/cgpj/es/Temas/Estadistica-Judicial/Estadistica-por-temas/Datos-penales--civiles-y-laborales/Civil-y-laboral/Efecto-de-la-Crisis-en-los-organos-judiciales/

[35] Cordero Lobato (2019) 182.

[36] Anderson & Simón (2017) 102.

[37] SC decisions 27 January 2020 (ECLI:ES:TS:2020:164); 29 November 2021 (ECLI:ES:TS:2021:4376); 19 October 2022 (ECLI:ES:TS:2022:3751); 21 October 2022 (ECLI:ES:TS:2022:3946); and 28 September 2023 (ECLI:ES:TS:2023:4261). For a detailed analysis see Sancho Martínez (2023) 127 ff.

Regarding future challenges, the development of AI has led to rethinking the functioning of the mortgage market in aspects such as advertising, the provision of information or the possibility of digitising the entire process. In Spain, it is important to underline the approval of Law 11/2023, 8 May, which, in a bid for digital transformation, has reformed the Mortgage Act and the Notaries Act to enable telematic notarial and registry intervention for certain instruments, such as the cancellation of securities, but not the creation thereof, which is much more complex. In addition, the Proposal for the modernisation of the Spanish Civil Code on obligations and contracts[38] seems to be moving in the direction of digitalisation, by incorporating in the proposed Art. 1228, relating to contracts concluded electronically, the possible identification by electronic signature, although it is worth noting that the competent authorities can exclude its use in 'contracts that create or transfer rights over immovable property', i.e., in those whereby a mortgage is created. Therefore, at the moment digital contracting does not seem a reality in Spain, which may be motivated by the risks it involves: the digital divide concerning people who are less familiar with the use of technology (elderly, disabled) and the likelihood that consumers do not read terms and conditions when presented in digital format, which may lead to a laxer scrutiny of important documentation. That was alleged in relation to a contract concluded by email in SC decision 13 March 2023.[39]

2 Creditworthiness Assessment: Mechanisms and Non-Compliance

The assessment of creditworthiness came to the fore in the aftermath of the deep crisis of 2008[40] and today no one doubts the crucial importance of verifying the economic capacity of the borrower before granting credit. However, there are important gaps on how to carry it out and the sanctions provided in Spain against the lender who fails to comply with its obligation are undoubtedly insufficient.

2.1 Creditworthiness Assessment in the MCD and in the LCCI

The creditworthiness assessment is of particular importance for the MCD, as shown by the fact that Art. 1 refers to it when defining the purpose of the regulation, but it only states principles that do not crystallise into specific measures and leaves it to Member States to determine the specific factors to be considered, as well as the procedure, and even the consequences of non-compliance for the creditor.

[38] Ministry of Justice, July 31, 2023.

[39] ECLI:ES:TS:2023:874.

[40] On the reasons and consequences of the crisis, see Anderson & Simón (2017) 50-55.

In Spain, there was regulation on this topic prior to the LCCI[41] because, in fact, it is a practice that lenders have been implementing given their logical interest in contracting with those who have the economic capacity to meet their obligations. The LCCI incorporates a qualitative leap by stating that it is a legal obligation and, therefore, of an imperative nature. Nonetheless, it incorporates almost literally the provisions of the MCD without adapting them to the rules that already existed and leaves some issues to be regulated at a later stage by Royal Decree (final provision 15(1)(h)), which were not approached despite the approval of RD 309/2019.

As to the content for carrying out the assessment, Art. 11(1) LCCI lists, albeit by way of example, the 'relevant factors' that the creditor must consider in order to verify the applicant's economic position, namely 'the employment situation, current income, foreseeable income during the life of the loan, assets owned, savings, fixed expenses and obligations already assumed', as well as the foreseeable level of income to be received after retirement 'if a substantial part of the credit is expected to be repaid after the end of the applicant's working life'. The information collected must be 'proportionate and limited to what is necessary', in compliance with data protection law (Art. 12(1) LCCI), but it is not always straightforward to ascertain whether all the required data comply with this parameter (e.g. the movements of accounts in other financial institutions).[42]

On the other hand, neither the MCD nor the LCCI specifies how the assessment process should be carried out and how all the data obtained should be combined. There is no doubt that the most relevant factor will be the borrower's regular income; however, legislation does not provide for a specific LTI ratio, which could be useful, albeit merely as a guideline.[43] The LCCI also allows the use of automatic data processing to measure the borrower's risk of default but this method, based on the borrower's past credit history, disregards the applicant's current financial situation and circumstances, so it appears to be poor if not accompanied by other elements.

Unless the result of the solvency assessment is positive, the borrower must refuse to grant credit following Art. 11(5) LCCI. The question is what the consequences of non-compliance with the prohibition would be. In fact, the LCCI only contemplates the hypothesis that the (positive) solvency evaluation is based on incomplete, false or erroneous information (Art. 11(4) LCCI), where two scenarios are distinguished: first, if the information provided by the applicant was incomplete, the contract could not be affected to his or her detriment, since the lender should have been aware of the

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[41] Law 2/2011, 4 March, on Sustainable Economy, and its development through Order EHA /2899/2011, LCCC, *inter alia*.

[42] Hidalgo García (2021) 153 ff.

[43] Marín López (2019) 239-241; Cuena Casas (2020) 198-199, 212.

deficiency and therefore must be responsible; second, if the borrower knowingly withheld or falsified the information, the lender can terminate the contract. Nevertheless, it does not seem that this situation will easily arise: if the borrower is fulfilling the payment obligations, the lender will have no interest in terminating the loan; whereas, if default occurs, the creditor will prefer to use the acceleration clause and claim the restitution of the principal together with interest, taking advantage of the mortgage.[44]

So, in short, there would be non-compliance if the assessment is not carried out, if it is incomplete or incorrect, and if credit is granted despite the negative result. This is where both MCD and Spanish law should focus their attention, but neither establishes any private-law remedy apart from the rule that prevents the creditor from withdrawing from the contract, unlike what happens when it is the borrower who has withheld or falsified information.[45] In fact, the LCCI only provides for a system of an administrative nature (Arts 44 ff.), which has proved ineffective in the past;[46] instead, private-law measures would be welcome, including: the loss of ordinary and default interests or commissions, the impossibility of enforcing the mortgage despite the acceleration clause, the loss of ancillary guarantees (mortgage, surety) or the refusal to register the mortgage when the creditor cannot prove, at the time of registration, that the creditworthiness assessment has been adequately passed, or even the loss of the loan principal or the excess which, according to the evaluation, should not have been lent; sanctions that could also reach the insolvency field, for example, by ordering a subordination of the credit or that the credit may be affected by the fresh start mechanism.[47]

In the absence of specific regulation, it has been questioned whether general remedies could be applied. The applicability of nullity, voidability or resolution could be defended, but none of them is fully satisfactory if, as a consequence, the borrower must return the principal loaned when it will probably have been used to pay the price of the property. It would only remain, then, to decide whether civil liability could be imposed on the lender for damages caused by the irresponsible granting of credit. It seems like the most reasonable solution, so that the judge can estimate, considering the amount lent and the one that should have been lent, an eventual

[44] Marín López (2019) 235-236.

[45] Arroyo Amayuelas (2017) 28.

[46] Marín López (2019) 251.

[47] Anderson (2016) 57-58 and by the same author (2017) 83-89; Marín López (2019) 213, 254-255; Busto Lago (2019) 49 and ff.; Cuena Casas (2020) 226-235.

release of the debtor,[48] although there are numerous doubts in the doctrine,[49] regarding its non-contractual or contractual nature and the concurrence of the necessary requirements for its exercise, mainly that related to attributing the damage to the creditor.[50]

Of course, for the penalty to be enforceable, it will be necessary to prove the lender's failure to fulfil the duty. That would be difficult for the borrower to prove, especially because the LCCI does not require, as provided for in Art. 18(2) MCD, the data on which the assessment is based or even the procedure to be documented. For this reason, it is encouraging that the ECJ decision in Case C-449/13 CA *Consumer Finance SA* v. *Ingrid Bakkaus, Charline Bonato & Florian Bonato* [2014] established, within the scope of the CCD 2008, that the lender has to provide proof. The same rule can be applied here and perfectly fits with the principle of availability and ease of proof enshrined in the Spanish Law on Civil Procedure (Art. 217(7) LEC).[51] Another question is whether the penalty could be imposed when the debtor, despite the irresponsible lending, is finally able to fulfil the contractual obligations. In this regard, the very recent ECJ decision in Case C-755/22 *Nárokuj s.r.o.* v. *EC Financial Services, a.s.* [2024], in the interpretation of Arts 8 and 23 CCD 2008, holds that the creditor may be sanctioned under national law with the nullity of the consumer credit agreement and the loss of the stipulated interest, even though the consumer has fully paid the credit without suffering the damages derived from the breach of that duty, as the obligation to assess creditworthiness is intended not only to protect consumers but also to make lenders liable and deter them from granting loans irresponsibly.[52]

2.2 New Challenges: Artificial Intelligence and Sustainability

As in many other sectors of the society, AI systems are being used by Spanish financial entities to determine the probability of potential borrowers complying with the obligations stemming from the contract.[53] The problem is what data is being used to

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[48] Arroyo Amayuelas (2017) 27.

[49] See a good summary in García Pérez (2020) 281-286.

[50] Marín López (2019) 252-254.

[51] Marín López (2019) 247.

[52] Given this decision, the JPI No. 1 of Fuenlabrada has, by order of 31 January 2024, referred a question to the ECJ for a preliminary ruling to ask whether Arts 8 and 23 CCD 2008 oppose an interpretation of national law whereby the mere provision of administrative sanctions excludes the possibility of declaring the nullity of the credit agreement or of imposing another civil consequence.

[53] Santander, BBVA, Caixabank, Banco Sabadell, ING and Evo Banco are among the entities that use this technology: https://okdiario.com/economia/del-scoring-computacion-cuantica-asi-conceden-hipotecas-santander-bbva-caixabank-9824300; https://www.abc.es/economia/ia-velocidad-extra-analisis-hipotecas-20240310211443-nt.html?ref=https%3A%2F%2Fwww.google.com%2F.

achieve credit scoring and if they are incorporating 'alternative' or 'non-traditional data' in their algorithms to assess the borrower's creditworthiness, that is, if consumer's offline and online activity is being used to collect data. In fact, alternative data sources, of questionable veracity, may encourage false positives or false negatives, and may severely compromise consumer privacy and data protection.[54] For that reason, the new CCD 2023 has established that the information collected may, under no circumstances, include data concerning the so-called 'special categories of data', which in the Spanish Organic Law 3/2018, of 5 December, include, among others,, racial or ethnic origin, political opinions, religious or philosophical beliefs and sexual orientation. Furthermore, the CCD 2023 expressly excludes the use of social networks. The AI Regulation recently adopted by the EU confirms that this is not a minor issue, since it classifies as high-risk systems those aimed at assessing creditworthiness.

Just as AI poses new challenges, sustainability is also on the European agenda and is directly linked to the issue at stake here. In fact, the aim is to stablish a correlation between energy efficiency and risk,[55] provided that better energy efficiency of the building will result in a lower energy bill and, consequently, will increase the ability of the debtor to pay. This premise, together with the fact that the eco-label adds value to the mortgaged property and reduces part of the risks associated with the mortgage market (defaults, depreciation of the property) including future risks (losses caused by climate change, etc.),[56] could be considered when assessing the creditworthiness of the potential borrower,[57] as permitted by Art. 11(3) LCCI. As a matter of fact, it exempts from the general rule that the assessment should not be based predominantly on the present or future value of the mortgaged property, the case in which the purpose of the credit agreement is the construction or renovation of the property.

However, as rightly pointed out, there is a patch of uncertainty that should not be overlooked: i) given the volatility of energy markets and the constant development of technology, it cannot be said with absolute certainty that what is energy efficient today will remain so; ii) the increase in the value of the mortgaged property may be circumstantial and is exposed to different risk factors (rapid obsolescence of improvements, the impact of systemic crises, etc.), while the investment will be high in any case; and iii) the lower risk of default may be due to the profile of those who

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[54] Cuena Casas (2019) 282 ff.

[55] EeMAP (https://hypo.org/app/uploads/sites/2/2018/03/Emerging-Analysis.pdf), 4 and 11.

[56] Barros Rocha (2019) 50-54, 106; De Ayala *et al.* (2016).

[57] Directorate General for Financial Stability, Financial Services and Capital Markets Union (European Commission), Risk & Policy Analysts (RPA), 'Report on the Evaluation of the Mortgage Credit Directive' (Luxembourg, Publications Office of the European Union), November 2020 (https://data.europa.eu/doi/10.2874/41965) 15, 69, 96.

have access to higher value investments such as energy efficient ones, i.e. those who have greater economic resources and are naturally less exposed to the risk of default.[58]

Apart from that, 'green financing' includes better conditions linked to the mortgage for buyers who improve the energy efficiency of their home or directly acquire sustainable properties. The challenge is to make this type of 'green' mortgage a competitive product, as practice shows an insignificant use in Spain, where, according to data provided by Green Building Council Spain (2018), seven entities had launched 'Energy Efficiency Pilot Mortgages', of which only three belonged to the financial sector.[59] This number has increased recently, with other entities that offer this type of product,[60] although the incentives are insignificant: a 0.10 point reduction in the interest rate or waiving the arrangement fee.[61] Indeed, there are some obstacles to be faced, such as how to determine whether the purchased house is efficient, considering there is no single international certification system and the common label for the whole EU is far from being a reality due to obvious geographical differences.[62] Furthermore, it could be questioned what concrete measures can be imposed on the lender to favour this type of product (lower interest rate, higher financing), without contravening the freedom of contract. Finally, it is also necessary to develop information campaigns, aimed at the general public, to raise awareness of the positive effects of residential energy improvements,[63] and, in turn, to tackle green washing.[64]

IV. Arrears and Mortgage Enforcement

It is well known the concern of the European legislator as to lenders manage emerging credit risks at an early stage and do their best to remedy the situation before starting enforcement proceedings. That is why Art. 28(1) MCD calls on Member States to adopt measures encouraging lenders to show 'reasonable forbearance', through

[58] Anderson (2023) 127-128.

[59] Triodos Bank, Caja Rural de Navarra and Unión de Créditos Inmobiliarios (https://gbce.es/2018/06/siete-entidades-espanolas-ponen-en-marcha-hipotecas-piloto-de-eficiencia-energetica/)

[60] For instance, Banco Santander, ING, BBVA, Bankinter, Abanca and Unicaja.

[61] https://www.ocu.org/dinero/hipotecas/noticias/hipoteca-viviendas-eficientes

[62] Souto *et al.* (2019) 4 and 28.

[63] Biere Arenas *et al.* (2023); Checa and Biere (2017).

[64] See final report issued by EBA on 'Greenwashing monitoring and supervision' (https://www.eba.europa.eu/sites/default/files/2024-05/a12e5087-8fd2-451f-8005-6d45dc838ffd/Report%20on%20greenwashing%20monitoring%20and%20supervision.pdf), according to which the EU financial sector accounts for a higher share of the total alleged greenwashing cases reported on EU companies in 2023: 21%, including 8% for the EU banks.

appropriate restructuring or refinancing measures. It also contains other measures aimed at consumer protection, such as limiting the charges that can be imposed for non-payment, enabling the parties to agree that the transfer of the security is enough to satisfy the debt and stating that the best possible price for the property has to be obtained in the proceeding.

1 Alternative Measures to Mortgage Enforcement in Spain

1.1 Examples of 'Reasonable Forbearance'

The 'reasonable forbearance' required on lenders was initially interpreted by Spanish doctrine as a guide and measure for the regulation of accelerated repayment clause and, therefore, as the requirement that the lender should only be allowed to apply it when the default was significant. This idea, connected with the problem in Spain of the enormous litigation surrounding unfair terms and, among them, the acceleration clause, was addressed by Art. 24 LCCI. The legislator itself acknowledges, in the Preamble of the law, to regulate aspects that are not specifically provided for in the European regulation. This provision is a clear example of this.

Thus, Art. 24 LCCI introduces a mandatory and considerably stricter regime, in contrast to the previous regulation, for the acceleration clause to be applicable. In light of the numerous rulings of the SC and the ECJ that considered the clause providing that the non-payment of one or three instalments entailed early termination to be unfair (despite complying with the law: Art. 693(2) LEC), Art. 24 LCCI establishes the following requirements: a) the borrower has to be in default in the payment of the principal or interest; b) the amount of the instalments due and unpaid has to be equivalent to three percent of the capital granted or the equivalent of twelve monthly instalments (if the default occurs within the first half of the term of the loan) or seven percent of the capital granted or the equivalent of fifteen monthly instalments (if it occurs within the second half); and c) the lender must have demanded payment, giving the borrower at least one month to comply and warning that full repayment of the loan will be sought. It thus pursues a dual objective: first, to prevent future enforcements of mortgages concluded before the law was passed that could be jeopardised by the declaration of the unfairness of the clause (transitional provision 1(4)); and, second, to avoid possible structural problems in the enforcement of contracts concluded within the framework of the LCCI.

Although the norm contains some inconsistencies, it definitely improves the previous regime and best fits with the ECJ's doctrine, as it is based on a sufficiently serious breach by the borrower in relation to the duration and amount of the loan. However, it would have been appropriate to establish the lender's obligation to offer the borrower, at the latest when payment is required, an agreement to renegotiate the conditions of the loan.[65] Especially bearing in mind that the debtor who is not able to pay on time will probably not be able to do so the following month either, with the debt already accumulated, especially if the amount is increased by default interest and, if applicable, claim fees. The mere fact of allowing a more or less extensive period to elapse without any other additional measure, far from avoiding legal proceedings, will foreseeably lead the debtor, increasingly suffocated by the debt, to them.

In this regard, the Spanish legislator has allowed lenders to impose additional charges on consumers in the event of non-payment. Indeed, Art. 25 LCCI departs from the SC criteria[66] and provides that the default interest rate shall be the ordinary interest plus three percentage points,[67] without the parties being able to agree otherwise. Thus, according to the interpretation given by the Spanish Directorate-General for Registries and Notaries whereby the rule is deemed absolutely mandatory, the Spanish legislator would not only have set a maximum limit but also a minimum, preventing any agreement even if it were more favourable to the borrower's interests.[68] This understanding runs counter to the ultimate aim of the MCD, which is to protect the borrower. Therefore, it should be understood that the article contains a *relatively* mandatory rule, in the sense of setting a maximum limit, absolutely binding for professionals but dispositive for consumers (see Art. 3(2) LCCI and 92(3) TRLGDCU).[69]

In fact, that same entity has declared, in two decisions of 5 April and 12 June 2020,[70] where the LCCI was not applicable as it was a mortgage loan granted by an employer to its employee (Art. 2(4)(a) LCCI), that, outside the scope of that law, the legal rate of interest for late payment referred to in Art. 114 LH (the content of which, by the way, is exactly the same as Art. 25 LCCI) must be interpreted in the light of the European regulation as a maximum imposed to the lender, but not to the borrower-consumer: 'the purpose of protection of Directive 93/13/EEC against unfair terms —

[65] Martin Faba (2019) 588.

[66] The SC had declared that a default interest rate that entails an increase of more than two percentage points to the interest rate agreed in the contract was unfair: SC decisions 23 December 2015 (RJ 2015, 5714), 3 June 2016 (ECLI:ES:TS:2016:2401), 24 April 2019 (ECLI:ES:TS:2019:1317) and 27 June 2023 (ECLI:ES:TS:2023:2913).

[67] Although, in accordance with the mandate of Art. 28(2) MCD, the surcharge should not be calculated by reference to remunerative interest: see Arroyo Amayuelas (2021).

[68] Resolutions of 5 December 2019 (BOE 2.26. 2020), 19 December 2019 (RJ 2020\789); 15 January 2020 (RJ 2020, 2541); 28 January 2020 (RJ 2020, 168515); 5 December 2020 (RJ 2020, 783) and 14 September 2021 (RJ 2021\5530).

[69] Arroyo Amayuelas (2021); Martín Faba (2019) 640 and 660.

[70] RJ 2020, 3019 and 3368.

the level of protection of which does not seem to have been modified by the MCD—would be meaningless if the consumer could not reduce the maximum rate of interest for late payment set by law or even agree on no rate of interest for late payment at all'. So, it finally recognizes that 'such a consumer would be harmed by the aforementioned legislative reform' and that it does not make sense to resort to a non-literal interpretation that reduces the level of consumer protection of the Directive. To end the inconsistencies, it is worth noting that Art. 25 LCCI will only be applicable when the borrower is a natural person, being excluded when it is a legal entity, so that, paradoxically, if as the latter is a consumer, it will receive better treatment as the SC's two-point surcharge would be applicable.[71]

Returning to the principle of reasonable forbearance, understood now as an incentive for the lender to encourage the refinancing or restructuring of the loan (Art. 28(1) MCD in connection with recital 77), there are some examples in the Spanish legal system that should be mentioned. For instance, RDL 6/2012, 9 March, on urgent measures to protect mortgage debtors without resources and Law 1/2013, 14 May, on measures to strengthen the protection of mortgage debtors, debt restructuring and social renting, set out obligations to safeguard the interests of mortgage debtors in a situation of vulnerability. These regulations were enacted in the wake of the deep economic crisis of 2008 to protect mortgage debtors on the threshold of exclusion, through the regulation of a Code of Good Practices (voluntary for lenders, although most of them have adhered to it) that foresees three phases: the first is aimed at restructuring the debt, through a grace period on repayments of the principal, a reduction in the interest rate and an extension of the total repayment period; the second, in which institutions may offer a write-off of part of the debt; and the third, if neither of the two previous measures is sufficient, which provides for *datio in solutum* as a means of final discharge, with the possibility for the borrower to remain at home for two years by paying an affordable rent. According to the data contained in the preamble to RDL 19/2022, 22 November, since its enactment in 2012 and up to the fourth quarter of 2021, the parties adhering to the code have carried out a total of 62.526 operations, of which 54.190 ended with a restructuring of the outstanding debt, 19 with a debt write-off and in 8.317 cases an agreement was reached on *datio in solutum*. L 1/2013, for its part, introduces some reforms to the enforcement proceeding, which will be addressed later, and decrees the suspension of repossessions on primary homes of particularly vulnerable groups, a measure that, with the approval of RDL 1/2024, of May 14, has been extended until 15 May 2028, that is, for a total of fifteen years. However, it is a measure that satisfies no one: the debtor loses ownership, even though he or she can temporarily remain at home, while the creditor acquires property that must be maintained but cannot be enjoyed or profited from.[72]

[71] Cabanas Trejo (2020) 119.

[72] Anderson & Simón Moreno (2017) 98.

Other examples of reasonable forbearance can be found in measures adopted in the context of the health crisis caused by Covid-19,[73] which are no longer in force.

The latter is precisely the main criticism of the Spanish legislation: it provides for temporary measures framed in the context of global crisis so it does not guarantee that the creditor will generally be reasonably tolerant at any time.[74] It is true that the LCCI has partially expanded the limited scope of RDL 6/2012 and now applies also to contracts concluded after it entered into force, as well as to guarantors, in respect of their primary home (final provision 10 LCCI). According to the Preamble of the LCCI, the aim is to 'convert the Code of Good Practice into a permanent and compulsory mechanism'. However, as noted before, it is voluntary for financial institutions and cannot be demanded of non-adherents, unless they have purchased the credit, as recently provided for by RDL 19/2022, 22 November, in line with the NPL Directive. Moreover, adherence is foreseen for two years (automatically extendable) and, therefore, has a significantly shorter duration than the usual of mortgage loan contracts,[75] which adds a problem: while initially it required a formal declaration, the successive reforms of RDL 6/2012 provide for tacit adherence (e.g. additional provision 11 LCCI), so there is currently some uncertainty as to which institutions have adhered to which version of the Code.[76] Moreover, these measures only apply to borrowers who meet the special vulnerability requirements (related to family and economic circumstances) established by the regulations or, where applicable, those provided for in order to benefit from aid to tenants in RDL 6/2012.

For this reason, and if the goal is truly that the mortgage creditor will maintain a proactive attitude in the search for an alternative solution, a possible way would be to impose the obligation to resort to alternative dispute resolution before the filing of judicial proceeding, in the same way that is provided when it involves the habitual residence in the Consumer Code of Catalonia (Art. 132-4), the Housing Act of the Region of Murcia (Art. 59 *ter*) or the Andalusian L 3/2016, of 9 June (Art. 17(3)).[77] This measure has finally been introduced into Spanish procedural law by Arts 655 *bis* and 685(2) LEC, although limited to those cases where the mortgaged property is the

[73] RDL 8/2020, 17 March; 11/2020, 31 March; 15/2020, 21 April, 3/2021, 2 February.

[74] Anderson & Simón Moreno (2017) 95-98.

[75] Cordero Lobato (2019) 708.

[76] Cordero Lobato (2019) 708.

[77] Rivas Velasco (2016); Anderson & Simón (2017) 98; Muñiz Espada (2020) 34. The Draft Bill is currently being processed to create the Independent Administrative Authority for the Defence of Financial Customers for the out-of-court resolution of conflicts between financial institutions and their customers; however, once again, the opportunity to legislate in the indicated sense is being missed.

primary home of someone in a situation of economic vulnerability, and provided that the creditor is a housing company or a large holder of residential property. Then, the proof of having undergone a conciliation or mediation procedure becomes a requirement for the admissibility of the claim.[78] Of course, this reduces the agility of a security traditionally characterised by its expeditious enforcement. Nevertheless, the delay in the enforcement through the tightening of access to the acceleration clause, the suspension of repossessions, and the restructuring with the limited scope provided by RDL 6/2012 do not seem suitable measures to comply with Art. 28(1) MCD. In fact, unlike the European law, they are not aimed at avoiding the enforcement proceeding (note that the suspension of repossessions operates after the property has been adjudicated at auction), they only apply in relation to the consumer's habitual residence and not to any residential property, and they do not consider individual circumstances but are based on an objective scale that measures the exclusion threshold.[79] Nor does it seem appropriate to legislate hastily in the face of market fluctuations, as was the case with the sudden rise in interest rates triggered by Russia's military aggression against Ukraine, which RDL 19/2022, 22 November, sought to address.

In any event, it should be noted that the mandatory mortgage mediation can become a double-edged sword for the debtor who cannot comply with what has been agreed if it has been converted into a public deed (Arts 25 of L 5/2012, 6 July, on mediation in civil and commercial matters). In such a case, the creditor could resort to the enforcement (Art. 517(2)(2) LEC), which does not foresee the existence of unfair terms as a ground to oppose (Art. 556 LEC), so, through the mediation agreement, the content of the mortgage loan, the terms of which have not been subject to judicial control, would be shielded. This is why some authors have stressed the need to exclude this type of agreement from the possibility of direct enforcement.[80]

1.2 Datio in solutum and Prohibition of Pactum Commissorium

Art. 28(4) MCD establishes that 'Member States shall not prevent the parties to a credit agreement from expressly agreeing that return or transfer to the creditor of the security or proceeds from the sale of the security is sufficient to repay the credit'. In the same way, Art. 6(1)(h) LCCI includes among the basic information that must appear in the advertising of residential property loans, 'the debtor's option to be able to give in payment the mortgaged property as security for the loan, in full discharge of the debt'.

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[78] On the benefits and weaknesses of the reform, see Anderson (2024) 102-106.

[79] Anderson (2024) 99-100.

[80] García-Rostán Calvín (2021) 86-91.

This possibility should in no case be interpreted in the sense of permitting mortgage credit contracts containing the so-called *pactum commissorium*, i.e. an agreement whereby the secured creditor is allowed to appropriate the property given as collateral in the event of non-performance by the debtor. This agreement is expressly prohibited in Spain by Arts 1859 and 1884 CC. The basis of the interdiction has usually been placed in 'evident moral reasons'[81] and the requirement of commutativity of contracts, since there is an obvious risk that, given the pressures to which the debtor in need of credit can be subjected, the assets offered as collateral would be undervalued.[82] So, it is usually inferred that, if the parties themselves avert this danger, there would be no inconvenience in lifting the prohibition.[83] Furthermore, as argued by the Spanish Directorate General for Registries and Notaries, that solution would be close to the extrajudicial sale of the mortgaged property, in the sense of attributing the creditor the *ius distrahendi,* as long as certain measures are taken so that it is not detrimental to the debtor.[84]

Nevertheless, locating the basis of the prohibition in the postulate of the proportionality or commutativity of contracts is not convincing: first, because the idea of a 'fair price' does not exist in the Spanish legal system, so there is no reason to condemn an agreement, however harmful it may be for any of the parties; and, second, because there are specific remedies to deal with such imbalances, both in the internal relationship between creditor and debtor (see Art. 1 L 23 July 1908, on the repression of usury) and against third party creditors (*actio pauliana*: Arts 1111 and 1291(3) CC).

Yet, there is another explanation as to why the prohibition of *pactum commissorium* exists, which has a fully objective nature and gives it a specific meaning: an agreement of this type entails that the asset is subject in its entirety to the securing of the debt for the duration thereof, so its value is monopolised by the secured creditor and removed from the possibility of the debtor being able to obtain more financing. That is to say, there would be a total subjection of the value of the asset to the debt, whatever the amounts of both, which means that both the object itself and the

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[81] SC decision 4 February 2020 (ECLI:ES:TS:2020:312).

[82] Resolutions of the Spanish Directorate-General for Registries and Notaries (hereinafter, RDGSJFP)8 April 1991 (RJ 1991, 3138); 25 December 2018 (RJ 2018, 5995); 28 January 2020 (RJ 2020, 2547); 15 March 2021 (RJ 2021, 1557); 10 March2022 (RJ 2022, 3314) and 18 July 2022 (RJ 2023, 549), citing the resolution of 22 February 2013 (RJ 2013, 1989) and 5 September 2013 (RJ 2013, 8275).

[83] Thus, for example, when the parties agree on a *pactum marcianus*, i.e. when guarantor and creditor take all the necessary steps to ensure that the principle of commutativity is safeguarded in the award of the asset, by reference to objective criteria that allow the market value to be identified.

[84] RDGSJFP of 26 December 2018 (RJ 2018, 5995).

possible 'surplus' value that may exist are definitively removed from the capacity of the debtor to offer them again as security and, therefore, to obtain more credit. The prohibition is, therefore, a rule that ultimately encourages competition between financiers and prevents any of them from monopolising for their exclusive benefit and unnecessarily, any of the debtor's assets. Thus, this rule is a manifestation of one of the primary objectives that the nineteenth-century legislator pursued through the Spanish mortgage reform: the promotion and maximisation of credit secured by immovables. A guarantee that would allow the creditor to appropriate the asset would be incompatible with such an objective and would also be contrary to the principles of publicity and speciality that apply to the land mortgage system, since what they seek is to avoid reducing the debtor's ability to obtain credit on the land beyond what is strictly necessary.[85]

For the above-mentioned, the rule of Art. 28(4) MCD can only be understood, according to the Spanish legal system, as referring to the possibility of establishing a limit to the debtor's liability, so that the amount obtained at auction during enforcement discharges the debt; this possibility is already regulated as a limited liability mortgage (Art. 140 LH). Otherwise, we could refer it to the admission of *datio in solutum* which, however, as a substitute measure for enforcement, should not be included in the same credit agreement but will only proceed, where appropriate, at a later time and provided that certain requirements are met.[86]

2 Enforcement of the Security: Some Important Inconsistencies

The Spanish regulation has been subject to numerous reforms in recent times concerning the enforcement proceeding, mainly due to the rulings of the ECJ on unfair terms, since the well-known Case C-415/11 *Mohamed Aziz* v. *Caixa d'Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa)* [2013], including: the possible existence of unfair terms in the enforceable title has been added as a ground for opposition (Arts 557(1)(7), 561 and 695(1)(4) LEC), subject to *ex officio* control (Art. 552 LEC), with the consequences foreseen, including the possibility of appeal, in Art. 695(3) and (4) LEC; Art. 579 LEC has been amended to allow partial remissions of debt in cases of enforcement over the debtor's primary home when the amount obtained at the auction is insufficient to cover the claim; the minimum limit by which the creditor may be adjudicated? the mortgaged property has been raised in the case of primary homes (Art. 671 LEC); and, finally, as already mentioned, proof of having undergone a conciliation or mediation procedure has been established as a requirement for the admissibility of the claim under certain circumstances (Arts 655 *bis* and 685(2) LEC).

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[85] Galicia Aizpurua (2021) 250-267; and by the same author (2023).

[86] Rivas Velasco (2016); Cordero Lobato (2019) 198-199.

However, the Spanish legislator is far from complying with Art. 28(5) MCD, which requires Member States to articulate measures that make it possible to obtain 'the best price' for the property and facilitate repayment when the debt is not settled at the end of the proceeding. Indeed, the price that can be obtained depends on the procedure that the creditor chooses, on the destination of the property (habitual residence or not) and even on the amount owed.[87] Thus, upon breach of the secured obligation, the creditor may freely choose to recover the debt seizing other assets[88] or enforcing other personal guarantees that concur with the mortgage,[89] and the range of procedural options available to the lender (without prejudice to what has been expressly agreed) is very wide: (i) the exercise of the personal action based on the right of credit in the ordinary enforcement proceeding; (ii) the exercise of the mortgage action in the ordinary enforcement proceeding; (iii) the exercise of the mortgage action through the special summary procedure provided for in Arts 681 ff. LEC; and (iv) the extrajudicial notarial sale. In the first two cases, the property must be appraised within the enforcement proceeding (Arts 637 ff. LEC), unlike the last two, where the parties must have determined in the mortgage deed the price at which they value the property to serve as a starting price in the auction (Arts 682 LEC and 129 LH, respectively).

Moreover, in addition to the lack of concordance between the value of the property, if it is enforced by ordinary means (where the appraisal takes place at the time of enforcement: Arts 637 ff. LEC) or mortgage enforcement (where there is no such procedure), a new discordance is added between judicial and extrajudicial enforcement, caused by the lack of harmony between Art. 129(2)(a) LH, in the wording assigned to it by the final provision 1 of the LCCI, and Art. 682(2)(1) LEC. Indeed, the first one establishes now in the framework of the extrajudicial sale that the value to serve as a starting price in the auction may in no case be lower than the value indicated in the appraisal nor may it be different from that which has been set for enforcement. However, Art. 682(2)(1) LEC continues to provide that the price may in no case be less than 75% of the value indicated in the appraisal, i.e., the value may be reduced by 25%.

Therefore, the legislator has included another further differential element as regards the valuation of the mortgaged property depending on whether the creditor decides to enforce by judicial or notarial means. It is true that if the deed provides for the possibility of an extrajudicial sale, as is usual, and given that the starting price for the notarial sale must be equal to the appraised value and the enforcement value, the latter

[87] Anderson (2018) 222-228.

[88] SC decisions 4 December 1999 (RJ 1999, 9014), 23 November 2000 (RJ 2000, 9315) and 18 June 2008 (RJ 2008, 4702).

[89] SC decision 4 December 1999 (RJ 1999, 9014).

will probably be increased.[90] However, the Spanish Directorate-General for Registries and Notaries has gone a step further by establishing that, even though the mortgage loan deed does not include the out-of-court sale procedure, the most coherent interpretation under consumer protection legislation is to understand that Art. 129 LH has modified the criterion of Art. 682 LEC, in the sense of always requiring that the value at which the parties appraise the mortgaged assets for auction purposes cannot, in any case, be less than 100% of the appraisal value.[91]

Beyond the procedural plurality and consequent divergence in the price that can be obtained for the property, there is an even more pressing problem, namely the absolute lack of consistency between the appraisal value for the auction and the real one. The fact that the appraisal value is fixed from the very first moment, i.e. at the time of the constitution of the guarantee, produces a distortion that usually results in the price obtained not being the best that could be achieved and, consequently, in the debt not being settled at the end of the enforcement proceeding.[92] Moreover, as has been pointed out, historically there may have been a reason for setting that value from the outset: avoid the lengthy procedures for the appraisal of assets contemplated in the LEC of 1881, which required the intervention of up to three experts.[93] However, the circumstances have changed substantially: first, because the LEC of 2000 streamlines the procedure of appraisal by an expert in the ordinary enforcement proceedings (Arts 637 to 639 LEC); second, because the total duration of mortgage loans has increased considerably and the variation in the market value of property fluctuates more and more rapidly over time, so there can be a big difference between the appraisal price and the market price at the time of enforcement, especially if there were charges prior to the mortgage that had been discounted in the appraisal and which may well have disappeared; third, because of the percentages of adjudication of the property at auction, which further reduce the value assigned to the property to the detriment of the debtor; and fourth, because the possibility of subsequent modifications to the appraisal price set in the deed (during the security phase of the mortgage)[94] requires an agreement with the creditor and, where applicable, with the third party holder and subsequent creditors,[95] not to mention the problems that arise

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90 Cordero Lobato (2019) 675; García García (2022) 62.

91 RDGSJFP 23 December 2021 (RJ 2020, 5453).

92 Anderson (2018) 220.

93 García-Rostán Calvín (2021) 54.

94 RDGSJFP 24 April, 2017 (RJ 2017, 2074).

95 García-Rostán Calvín (2021) 56-63; González Pacanowska (2004) 2149-2168. However, the RDGSJFP 26 October 2016 (RJ 2016, 6053) has departed from what had been the criterion of the authors to understand that the consent of third parties is not necessary, since the modification of the appraisal value does not alter the registry rank nor does it place these third parties in a situation of

in the area of granting loans for properties under construction, where the Spanish Directorate General for Registries and Notaries has allowed the appraisal value to be raised.[96]

These questions have not received an adequate response from the legislator and Art. 682 LEC, despite having been reformed, continues to produce the same deficiencies noted above. The requirement that the starting price at auction should not be less than 75% of the value resulting from the appraisal, introduced by L 1/2013, was intended to adjust enforcements to the price fall due to the 2008 crisis and to cope with over-appraisals the time leading up to it. However, this provision does not respond to current needs, considering that appraisals must meet standards of officialdom and objectivity, so they are adjusted to market values.[97] Furthermore, the award criteria of Arts 670 and 671 LEC, especially when there are no bids or the bids do not reach the minimum price, of 50% and 70% of the appraisal value, are arbitrary and do not allow adaptation to the circumstances of each case;[98] also, they do not generally correspond to the depreciation values of the residential property stock. In fact, when the value of the property depreciates by more than 20% of the initial appraisal, the creditor can request the extension of the mortgage to other sufficient property (Art. 9 RD 716/2009, of 24 April), a remedy whose scarce use shows that the situation of the property market does not generally justify such strong depreciation as that resulting from Art. 671 LEC.[99]

For all the above reasons, we fully agree with the authors who argue that the mortgage enforcement should be reformed to require an updated valuation of the property so that it will be awarded to the creditor according to that value, with delivery of the surplus to subsequent creditors or to the debtor:[100] it is inherent to the mortgage that

defencelessness, insofar as they can intervene in the enforcement proceedings or pay the amount of the claim, being subrogated, or even request the rectification of the new valuation in a proceeding on the merits (Art. 40 LH).

[96] RRDGSJFP 4 June, 2014 (RJ 2014, 3826); 22 April 2015 (RJ 2015, 3297); 14 September 2016 (RJ 2016, 4645), and 8 May 2019 (RJ 2019, 2272).

[97] García-Rostán Calvín (2021) 59.

[98] Regarding the controversial interpretation of Art. 671 LEC, in cases of an unsuccessful auction of the debtor's primary home when the amount owed to the creditor is less than 70%, see SC decisions 15 and 17 December 2021 (ECLI:ES:TS:2021:4602 and ECLI:ES:TS:2021:4764, respectively).

[99] Díaz Fraile (2016) 386.

[100] González Pacanowska (2004) 2162-2164; Rivas Velasco (2016); Anderson & Simón (2017) 104; Zurita Martín (2020) 309-311. Díaz Fraile (2016) 382-388, also in favour of the revision of the percentages of adjudication, proposes as a subsidiary solution that the percentage of the appraisal value for adjudication to the creditor could be fixed by reference to official statistical indices of the evolution of house prices.

the value obtained as a result of the forced sale of the property can eventually be used to pay the creditor (Art. 1858 CC), but this requires it being valued at its fair price, even it this includes considering the expenses that the creditor may incur and not awarding it for 100% of the market value, in the event of an unsuccessful auction.[101]

Different civil law remedies have been proposed to alleviate the unfairness of the rule. These include unjust enrichment, abuse of rights, the allegation that the creditor is exercising its right in contradiction with the constitutional protection of property[102] or, finally, the possibility of challenging the term under the grounds that it produces an imbalance between the parties.[103] The Spanish legislator and case law have not been indifferent to these solutions, as shown by the reform of Art. 579(2)(b) LEC, according to which, if the creditor acquired the mortgaged property and sells it within 10 years of the enforcement, the remaining debt will be reduced by 50% of the capital gain obtained in the sale, provided it was the debtor's primary home.

In this context, the SC had been holding that there was no violation of the prohibition of unjust enrichment in the fact that the asset had been appraised at an amount much higher than the final adjudication value, as this was something expressly accepted by law. However, given the reform mentioned above and despite the impossibility of retrospective application, the court has changed its mind to understand that unjust enrichment could be noticed when, after the adjudication, and in a relatively short period, the creditor had obtained a very relevant capital gain, as this fact would show that the credit should have been considered satisfied in a greater proportion.[104]

The need to update the value used in the auction is, in our opinion, an imperative. However, some authors place the debate at an earlier stage, that is, in the very questioning of whether the judicial auction is the best possible mechanism and whether another system in which the creditor is granted powers of disposal would be preferable, provided, of course, that it is controlled and supervised by the judicial authority to prevent the lender from selling off to collect, even if only a small amount, to the detriment of other creditors as well as of the mortgagor.[105]

Finally, the MCD delegates to the Member States the adoption of measures to facilitate repayment in those cases in which the debt is not settled at the end of the

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101 Anderson (2018) 234-235.

102 On the viability of each of these claims see González Pacanowska (2004) 2162-2164.

103 Nicasio Jaramillo (2016) 81-102; Ruiz-Rico & Acebes (2017).

104 SC decisions 13 January 2015 (ECLI:ES:TS:2015:261); 5 March 2020 (ECLI:ES:TS:2020:729); and 7 September 2023 (ECLI:ES:TS:2023:3598).

105 Anderson (2016) 61; Arroyo Amayuelas (2017) 30.

enforcement, as Art. 579(2)(a) LEC provides when it allows partial remissions of the debt, in the case of the primary home, if within five or ten years the debtor satisfies 65 or 80% of the outstanding amount. This measure, however, once again is limited to proceedings involving the borrower's primary home; after losing it, the debtor will probably be far from being able to pay these amounts.[106] In the same way, the fresh start mechanism is perceived as not very effective, given the complexity of its incorporation into bankruptcy proceedings; but its reform through L 16/2022, of September 5, has resulted in an exponential increase in the number of proceedings involving natural persons,[107] which seems to finally contribute to satisfying the European objective of avoiding long-term debt.[108]

V. Final Remarks

The analysis of the MCD and its transposition into Spanish law reveals certain areas that require prompt regulatory intervention. Some of them are the result of the ambiguous terms used in the Directive or the Spanish legislator's inability to comply with European guidelines. Others are a consequence of market developments in recent years. The latter include the growing role that crowdlending platforms have adopted in the granting of credit, as well as the challenges posed by digitalisation or sustainability.

As regards the first group of measures, the need to establish a homogeneous regime in the area of mortgage contracts, which avoids the exclusions and inconsistencies that the MCD encourages and which only detracts from the legal certainty of this market, stands out. Similarly, the commitment to assess creditworthiness as the backbone of the granting of credit requires a more exhaustive regulatory development, in terms of the procedure to be followed and the data that can be used, as well as a definitive intervention in the area of civil sanctions to be imposed on those who fail to comply with this duty. This same need for specification requires, finally, the regulation of the measures that can be adopted in the event of default, going further along the lines of establishing a uniform regime that places enforcement as a last resort, in an attempt to promote 'reasonable forbearance' by the creditor and, ultimately, to avoid the injustices to which Spanish law leads due to the undervaluation of the mortgaged property.

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[106] Anderson & Simón (2017) 100.

[107] See statistics at https://www.registradores.org/actualidad/portal-estadistico-registral/estadisticas-concursales#portlet_com_liferay_journal_content_web_portlet_JournalContentPortlet_INSTANCE_92PKQIzgTNBS: so far in 2024, between 75% and 80% of the total bankruptcies are natural persons.

[108] Anderson (2024) 85-86.

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