

Responsible Lending and Responsible Securities in Mortgage Credits in Spain

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1. HOUSING MARKET AND ECONOMIC CRISIS IN SPAIN (2008-): THE PERFECT STORM

1.1. THE PREVIOUS SITUATION (1997-2008). THE PRIVATE OVER-INDEBTEDNESS AND ITS CAUSES:

- Gross Domestic Product (GDP) growth since 2000:

2000: 5%

2003: 3,1%

2004: 3,3%

2005: 3,6%

2006: 4,1%

2007: 3,8%

2008: 1,1%

Source: Statistic National Institute

- Housing market and housing bubble: the price of houses increases between **10-30%** every year from 2000 till 2007, and this attracts a lot of money (buyers to stay, buyers to let, investors...). Because: “*Prices never go down*”.
- Irresponsible practices and behavior by markets participants:
 - Minimum rate of interest in mortgage credits: euribor more **0,33%, 0,5%, 0,6%...**
 - Amortizing loan time in **30, 35 or 40 years**
 - Wide freedom to value the mortgaged property (flexible valuation standards): **more than 100%** LTV (loan to value)
 - Government support housing bubble with tax policy

1.2. THE SITUATION AFTER ECONOMIC AND FINANCIAL WORLD CRISIS (2008-)

- Recession in Spain: GDP since 2008:

2008: 1,1%

2009: -3,6%

2010: 0%

2011: -1%

2012: -2,6%

2013: -1,7%

2014: 1,4%

2015: 3,2%

2016: 3,2%

Source: Statistics National Institute

- The unemployment increases (unemployment rate):
 - 2008: 11,3%
 - 2009: 18%
 - 2010: 20,1%
 - 2011: 20,9%
 - 2012: 26,02%
 - 2013: 26,03% (more than 6 M people who want work, the can not work)
 - 2014: 23,7%
 - 2015: 20,9%
 - 2016: 18,63% (4,23 M)

Source: Employed Population Survey

- The bubble burst: between 2000-2014 the price of the houses decreased about 40% average (in Mediterranean Cost: -48,7%)

- Consequences: increase arrears, defaults and evictions
 - Since 2008: **600,000 evictions** in Spain
 - But the sale of the mortgaged property is not often enough to cancel the debt
- The main concern to the Government is banking rescue (banking bailout in June 2012: **61,000 M€**, 41,300 M€ from EU, like **direct help**), but there is not rescue for people
- Social and political crisis: '**15-M Movement**' and new parties in the Spanish policy ('Podemos' and 'Ciudadanos'). Political paralysis during 2016

2. PROTECTION OF THE CONSUMERS IN MORTGAGE CREDITS AND RESPONSIBLE LENDING

2.1. *RESPONSIBLE LENDING: A NEW CONCEPT IN SPANISH LAW*

- The first time: Sustainable Economy Act 2011 (04/03/2011), art. 29.
- Consumer Credit Act 2011 (24/06/2011), transposition of the Consumer Credit Directive (2008)
- The future transposition of the Mortgage Credit Directive (2014)

2.2. TWO BASIC OBLIGATIONS:

- Obligation to provide pre-contractual standardized information for consumers
- Obligation to assess the creditworthiness of the borrowers (consumers)
 - Regulation under the new legislation for borrowers
 - No regulation for the personal securities (contract of guarantee)

3. THE SECURITIES (BY THIRD PERSON) IN MORTGAGE CREDITS

3.1. MAIN ISSUES:

- Personal and real securities by third person in mortgage credits (mortgages and guarantees): a particular practice in Spain during the pre-crisis period
- Two main reasons:
 - **Under water mortgages**: the value of the property is lower than the amount of the loan (loan to value; LTV), and
 - **Superficial creditworthiness** assessments and **insufficient income** of the borrowers (loan to income; LTI) were supplied with new securities by third person
- The position of the securities in the contract:
 - Personal securities (guarantees): the same position that the borrower (solidary obligations usually)
 - Real securities (mortgages): the mortgaged property is responsible till a fixed amount

3.2. THE CONSEQUENCES WHEN THE DEBTOR IS IN DEFAULT FOR THE SECURITY PROVIDERS:

- For real securities (mortgages):
 - The mortgagee have a right to sell the mortgaged property (court process)
 - Three payments in arrears at least
 - The mortgagor remains liable for any shortfall (common situation)
- For personal securities (guarantees): the same consequences for the guarantor than for the principal debtor usually:
 - Guarantor and principal debtor are usually solidary debtors
 - The guarantor is liable with the whole inheritance
 - A contract of guarantee is an accessory contract

4. THE MORTGAGE CREDIT DIRECTIVE 2014

4.1. TITLE:

Directive 2014/17/EU of the European Parliament and of the Council of 4th 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) N.º 1093/2010

4.2. OBJECTIVES:

- To define a common *responsible lending* policy in Members States: measures and regulatory tools to a responsible behavior of market participants
- To achieve a high level of consumer protection in this field (informed decisions)
- To protect the consumer against the over-indebtedness

4.3. SCOPE: Art. 3:

(a) Credit agreements for consumers which are secured either by a mortgage or by another comparable security on residential immovable property, and

(b) Credit agreements for consumers the purpose of which is to acquire or retain property rights in land or in an existing or projected building

4.4. PRE-CONTRACTUAL INFORMATION:

The European Standardized Information Sheet (ESIS). Art. 14:

Member States shall ensure that the creditor and, where applicable, the credit intermediary or appointed representative, provides the consumer with the personalized information needed to compare the credits available on the market, assess their implications and make an informed decision on whether to conclude a credit agreement:

(a) without undue delay after the consumer has given the necessary information on his needs, financial situation and preferences in accordance with Article 20; and

b) in good time before the consumer is bound by any credit agreement or offer.

4.5. ADEQUATE EXPLANATIONS: Art. 16:

*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.***

4.6. OBLIGATION TO ASSESS THE CREDITWORTHINESS OF THE CONSUMER. Art. 18:

*1. 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 his obligations under the credit agreement.***

(...)

4. Member States shall ensure that where a creditor concludes a credit agreement with a consumer the creditor shall not subsequently cancel or alter the credit agreement to the detriment of the consumer on the grounds that the assessment of creditworthiness was incorrectly conducted. This paragraph shall not apply where it is demonstrated that the consumer knowingly withheld or falsified the information within the meaning of Article 20.

5. THE TRANSPOSITION OF THE DIRECTIVE IN SPAIN: NEW OPPORTUNITY TO MORTGAGE CREDIT AND NEW DOUBTS

5.1. DATE TO TRANSPOSITION:

On the **31st of March 2016**. Spain do not have a serious draft or proposal yet (we only have a “document” by the Government on August 2016, but our Parliament do not work about this yet)

5.2. SOME QUESTIONS ABOUT THE TRANSPOSITION IN THIS SUBJECT:

- What about an obligation to provide free of charge and specific information to the securities provided by third person?
- What about the assessment of the creditworthiness of the personal security providers? The Directive says about the ‘customers’, but it is only thinking about borrowers...
- What are the methods to assess the creditworthiness? Shall the lender consult specific database?

- Can the lender grant the loan if the assessment of the borrower is negative? Can the lender accept a security provider if the test of creditworthiness of the guarantor is negative?

Under Art. 18.5 (a) Directive, Member States shall ensure that:

*(a) **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 to be met in the manner required under that agreement;*

Under art. 20.4 Directive:

*4. Member States shall have measures in place to ensure that consumers are aware of the need to provide correct information in response to the request referred to in the first subparagraph of paragraph 3 and that such information is as complete as necessary to conduct a proper creditworthiness assessment. The creditor, credit intermediary or appointed representative shall warn the consumer that, where the creditor is unable to carry out an assessment of creditworthiness because the consumer chooses not to provide the information or verification necessary for an assessment of creditworthiness, **the credit cannot be granted**. That warning may be provided in a standardised format.*

- What are the effects if the lender infringes this prohibition (mandatory rules) and to grant the loan or accept the guarantor despite the negative test?

6. PERSONAL (AND PROVISIONAL) OPINIONS

6.1. A DUTY TO PROVIDE SPECIFIC PRECONTRACTUAL INFORMATION FOR SECURITY PROVIDERS IS NECESSARY:

- In my opinion it is necessary to apply the European Standardized Information Sheet (ESIS) to security providers (informed decision) and to include at least:
 - The conditions of the contract of loan and its terms
 - The conditions and responsibilities assumed according to the security
 - The borrower creditworthiness's result

6.2. AND A DUTY TO ASSESS THE CREDITWORTHINESS OF THE PERSONAL SECURITY PROVIDERS (GUARANTEES):

- This assessment shall be according with the conditions and responsibilities assumed by the guarantors. If the guarantor assumes the borrower's same position, then the creditworthiness assessment shall be the same

6.3. THE CREDITWORTHINESS ASSESSMENT MUST BE STRICT AND INCLUDE A NUMBER OF MINIMUM REQUIREMENTS

- Prudential Law shall specify this requirement and guidelines to assess the financial situation and credit history of the borrowers and the guarantees, and put limits on LTV (loan to value) and LTI (loan to income) ratios
- Amount and cost of the credit must be according to the risk

6.4. OBLIGATION TO DENY THE LOAN OR REFUSE THE PERSONAL SECURITY IF THE CREDITWORTHINESS TEST IS NEGATIVE

- According to the Directive (arts. 18.5 and 20.4) another answer is not possible, but the parties can change the loan or the guarantee according to the test result

6.5. AN IMPORTANT ISSUE: SUPERVISION AND EFFECTIVE ENFORCEMENT

- Supervision (Bank of Spain) and severe punishments are necessary: severe fines, withholding the lender's license, and others
- In particular, in case of negative creditworthiness test: possibility of punishments in the contract
 - Two possible alternatives: the contract is rendered ineffective (null) or the contract have full effect between private parties
 - Possible solution for the borrower (with negative test): In this case I think an appropriate and proportional sanction could be that the contract have full effect, but the lender could lose some benefits of the contract. For example, the loss of the agreed interests
 - Possible solution for the personal security providers (with negative test): the lender shall lose the guarantee
- But these proposals are under discussion. Two tensions: access to credit and credit risk in mortgage: the tension of extending credit at acceptable risks

THANK YOU VERY MUCH