Chapter 2

A Legal Perspective of the Origin and the Globalization of the Current Financial Crisis and the Resulting Reforms in Spain[1]

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Introduction

This chapter examines the legal factors which were central to the US subprime crisis, the international credit crunch and subsequent global economic developments. The negative impact of the international financial crisis on the Spanish housing system is considered, as well as the limited nature of reforms in the Spanish mortgage and housing markets. It is suggested that deficient regulation in the US mortgage securitization process has been the catalyst for the global crisis; however, its impact has generated significant changes in national mortgage and housing legislation in the affected countries. Some innovative developments are examined, such as increased protection for mortgage consumers and an intermediate tenures project in Catalonia.

From the US Subprime Crisis to the International Credit Crunch and its Legal Context

Background to the Crisis

The devastating impact of the US mortgage crisis, involving massive mortgage defaults, across the world was fundamentally due to international 'mortgage securitization' (see Figure 2.1). This is a financial technique to 'transform' mortgages into securities. It provides funding for a mortgage originator's lending business through the issue of mortgage-backed securities (MBSs) by a special purpose vehicle (SPV). In itself, it is not a detrimental process, since it allows lenders to access greater levels of funding. However, once the original mortgage, which is the collateral base of the security, is defective, the whole process becomes contaminated.

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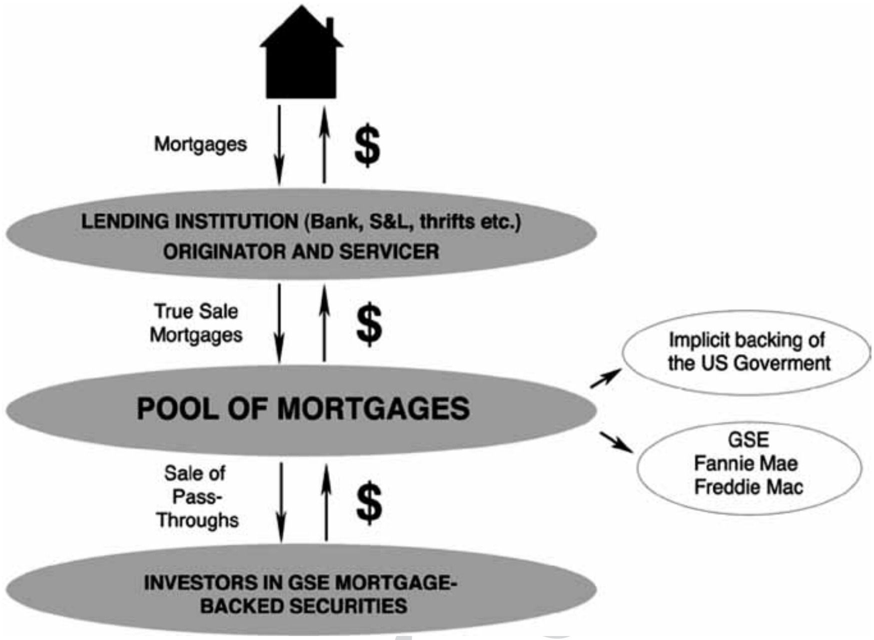

Figure 2.1 Standard US mortgage securitization.
Source: own ellaboration

The degradation of the quality of securitized mortgages in the US arose from two main sources.[2] First, the general policy of maximizing home-ownership at any cost, even to those households that clearly did not have the resources to repay mortgage loans, created an unsustainable financial subsystem. This situation arose due to borrowers' limited economic capabilities and/or because of the conditions of the mortgages themselves, such as a high loan-to-value ratio (LTV) coupled with a high interest rate. Both Republican and Democrat administrations promoted home-ownership as part of the American Dream. As far back as 1994, President Clinton promoted wider home-ownership: 'More Americans should own their own homes, for reasons that are economic and tangible, and reasons

2 There are others which are also important but which cannot be addressed here, such as the insufficient backing given by the US government to the agencies that issued the MBSs, the lack of a proper body of rules for MBS business in the US and the lack of liability for losses of rating agencies in that jurisdiction. See Sergio Nasarre-Aznar, *Securitisation and Mortgage Bonds. Legal Aspects and Harmonisation in Europe* (Saffron Walden, Gostick Hall 2004) 39. This book also discusses the weaknesses of some international mortgage securitization systems.

that are emotional and intangible, but go to the heart of what it means to harbour, to nourish, to expand the American Dream'.[3] President George W. Bush endorsed this approach and encouraged many ethnic groups to become home-owners.[4] Of course, this generalization of home-ownership necessitated a concurrent expansion of mortgage lending. A lowering of standards was also required in mortgage underwriting, and thus a reduction of quality of mortgages. There was a corresponding increase in the default risk of mortgages, which could not be borne by most lenders. For this reason, government-sponsored enterprises (GSEs),[5] such as Fannie Mae, Freddie Mac and Ginnie Mae, were authorized to buy what were increasingly less sustainable mortgages from lenders in order to transform them into securities, thus generalizing, externalizing and internationalizing this default risk. This process is explained in more detail below.

Second, the moral hazard or conflict of interest inherent in the US model of mortgage securitization was hugely significant. It allowed lenders to pass on any default risk in the repayment of the mortgages through to MBS investors, many of whom were European, international banks and other financial institutions.[6] These institutional investors almost blindly relied on international rating agencies' assessments and the theoretical/implicit backing of the US government to their

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3 Speech of Bill Clinton, 42nd President of the United States of America, 'National Partners in Homeownership', before the Association of Realtors (Washington DC, 1994).

4 See the American Dream Downpayment Initiative, which was signed into law on 16 December 2003 and provided 'downpayment, closing costs, and rehabilitation assistance to eligible individuals' (for more details, see http://www.hud.gov/offices/cpd/affordablehousing/programs/home/addi/ accessed 29 October 2012.

5 Mortgage GSEs were created by the US Congress with the aim of improving the flow of credit into certain housing markets while reducing the cost of that same credit.

6 See H Blommestein, A Keskinler and C Lucas, 'The Outlook for the Securitisation Market' (2011) 1 OECD Journal: Financial Market Trends 2 at 3. The authors stated that 'regulation and underwriting standards were seen to be significantly more robust in Europe', that 'there's no doubt that the securitisation asset class in general was tarnished by the fallout from the US subprime crisis' and that 'from mid-2007 to the end of 2010, only 0.95% of all European structured-finance issues defaulted, compared to 7.7% of US structured-finance issues'. See also J Cox, J Faucette and C Valenzuela, 'Why Did the Credit Crisis Spread to Global Markets?' (2010), available at http://blogs.law.uiowa.edu/ebook/uicifd-ebook/part-5-ii-why-did-credit-crisis-spread-global-markets, pt 5, p 3 and 17, which says that 'European banks became involved when they invested in AAA-rated asset-backed securities (i.e. subprime mortgage-backed securities) produced in the United States', that 'Because European banks had heavily invested in U.S.-produced MBS, they were greatly exposed to those assets once they became toxic. By February 2009, European banks, specifically banks in the United Kingdom, had seventy-five percent as much exposure to toxic assets as U.S. banks' and that 'unfortunately, a "perfect storm" of regulatory breakdowns allowed what initially was a mortgage crisis in the United States to morph into a global financial crisis via securitization'.

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GSEs.[7] We now know that among these securitized mortgages were those created through the 'predatory lending' of subprime mortgages.[8]

Subprime mortgages are those that do not fulfil the quality standards for repayment for one reason or another. In the US, a variety of these were created in unusual circumstances. These included situations where the LTV surpassed 80 per cent or because these were second mortgages (often described as 'piggy-back mortgages')[9] that were charged on the remaining 20 per cent LTV after an existing mortgage for the first 80 per cent of LTV. Mass default on the mortgages arose when housing prices dropped as mortgagors could not refinance their debts. Even in non-recourse states, mortgagors voluntarily defaulted once their mortgage debt was more than the value of their property.[10] This impacted negatively on MBSs and had an even more detrimental impact on those securities known as 'collateralized debt obligations' (CDOs),[11] where the true risk was almost impossible to properly assess, due to their financial complexity and the remoteness of the underlying collateral. The result was the holding of 'toxic assets by many international financial institutions'.[12] Other structural conflicts of interest in the standard US mortgage securitization process included the lack of incentive for the originator to reveal the true value of a pool of mortgages when they are transferred to the arranger of the issue, and there may indeed

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7 See the explicit assertions of N Eric Weiss, 'Fannie Mae's and Freddie Mac's Financial Problems', Congressional Research Service, CRS Report for Congress (10 August 2012) 17 http://www.fas.org/sgp/crs/misc/RL34661.pdf assessed 4 October 2012: 'Fannie Mae and Freddie Mac are GSEs whose charters limit them to buying single family and multifamily home mortgages originated by others. This lack of diversification makes them more exposed to housing and mortgage market problems than other financial institutions such as commercial banks that have other lines of business. The GSEs' charters give them a special relationship with the federal government, sometimes called an implicit guarantee, which has allowed them to borrow at interest rates only slightly above those paid by the federal government'.

8 See '"Malicious Mortgage" Nets 400 Defendants' (19 July 2008), https://www.fbi.gov/news/stories/2008/june/malicious_mortgage061908) accessed 4 October 2012, which relates to mortgage fraud schemes that involved 400 defendants.

9 See Jack Guttenburg, 'Mortgage Crisis Drives Home Value of PMI' *InMan News* (8 April 2008) http://www.inman.com/buyers-sellers/columnists/jackguttentag/mortgage-crisis-drives-home-value-pmi accessed 4 October 2012.

10 Todd J Zywicki and Joseph D Adamson, 'The Law and Economics of Subprime Lending' (2009) 80(1) University of Colorado Law Review 31 and 32. See also Andra C Ghent and M Kudlyak, 'Recourse and Residential Mortgage Default: Evidence from US States', Federal Reserve Bank of Richmond Working Paper No 09-10R (2011) 29.

11 CDOs are asset-backed securities issued over collections of MBSs, i.e., 're-securitized' mortgages.

12 This 'toxicity' meant that, even if the mortgages had not defaulted, the market for them had now disappeared, their value then dropped and the holders (the banks) were obliged to correct their books to show this 'write-down' loss in order to reflect the new real market value of the assets.

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have been an incentive to hide its risks.[13] There was also little to incentivize the originator to properly monitor the behaviour of mortgagors in matters such as timely repayment or risky behaviour towards the property, as he or she had already sold the mortgages to the arranger, passing on any risks of default to the MBS investors. While these risks were difficult to avoid, as they are part of a standard mortgage securitization process, they could have been reduced through effective supervision, due diligence and disclosure obligations.

Legal Regulatory Weaknesses

While these two factors are widely accepted as causes of the US financial crisis, there has been little published analysis of the legal factors behind these developments. From a legal perspective, there were at least three causative factors that explain the collapse of the 'house of cards' of the US mortgage market.

First, the lack of a strong regulatory framework for MBSs led to an 'outlaw-like' securitization process. Unlike the highly regulated covered/mortgage bonds, such as *Pfandbrief* in Germany,[14] the situation is different in the US, and indeed all common law countries. These lack a strong and specific regulatory framework, and often there is no clear-cut and dedicated legislation that specifically deals with MBSs.[15] In my opinion, this situation leads to the circumstances shown in Table 2.1, which are evidenced to some extent by the better financial performance of covered bonds, as compared with MBSs, from the start of the credit crunch onwards.[16]

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13 The one who financially builds up the pool of mortgages to be securitized.

14 See, for more details, Nasarre-Aznar (n 2) 5–13.

15 Traditionally, many authors in the US see the intervention of the state – even with a piece of legislation – in the economy as a mistake, although the fragility of the US banking and financial system has been evident throughout its recent history. See the numbers of insolvent US banks during the twentieth century in Maury Klein, 'The Panic of 2008: Something Old and Something New' in Lawrence E Mitchell and Arthur E Wilmarth, Jr (eds), *The Panic of 2008. Causes, Consequences and Implications of Reform* (Cheltenham, Edward Elgar Publishing 2010) 49. For the situation in the UK, see Nasarre-Aznar (n 2) 24.

16 See the constant ascending outstanding covered bonds from 2003 to 2011 in European Covered Bond Council, *Fact Book*, 7th edn (September 2012) 54. Although with the help of the European Central Bank and European national central banks that provide liquidity to the system (at 21), covered bonds have performed relatively well since 2007 to the point that 'the covered bonds asset class is still the main pillar for real estate financing in Europe' (at 31). Most problems for covered bonds do not arise from their intrinsic standard legal structure, but from the decrease of mortgage lending in some EU countries and the problems with the Eurozone sovereign debt crisis (at 31 and 32), while the transparency to investors remains essential (at 32). This contrasts with MBSs. The outstanding principal balances of MBSs insured or guaranteed by the US agencies has constantly decreased from $7.5 trillion in 2008 to $2.9 trillion in second quarter of 2012 according to the US Federal Reserve: http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm#fn5r) accessed 3 March 2013. Moreover, since the crisis, MBSs have faced increasing

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Table 2.1 Regulated versus non-regulated mortgage markets

Non-regulated contexts (most MBS contexts)	**Regulated contexts (most covered bonds contexts)**
More flexibility (unlimited types of MBS structures that may be adapted quickly to the market)	Less flexibility (basically, each national covered bond has its own law; non-legal covered bonds may exist. but are riskier than regulated ones)
Contractual basis (to which extent should exist an obligation to disclose contractual information to third parties)	Legal basis (everything is public: collateralization ratio, role of cover assets monitor, minimum quality of covering mortgages, etc.)
Rights of the stakeholders left to general rules of law	Specific rules for misbehaviour, losses, etc.
More dependence on 'private opinions' such as the rating agencies or government direct sponsorization (e.g. the GSEs, that distort the free (concurrence competition) in the MBS market in the US)	Transparency of the law need (the lowest profile of state intervention) reduces the need for rating agencie
More complex structures (more difficult to understand by investors and other stakeholders; more intermediation costs	A simpler and straightforward structures (transparency

Contract-based securitization differs fundamentally from covered bonds governed by public law regulation. The attributes of public law regulation derive from its public character, where rules are published in official documents. It also offers transparency, in the sense that these rules, regulations and expected outcomes are accessible to everyone, usually without charge (increasingly through the Internet) and often translated into English. The rules can be easily understood, not least by stakeholders. On the other hand, contractual-based securitization is closed. Only contract arrangements bind the parties and there are no clear rules on the disclosure of specific information to others involved in the transaction,

legal and regulatory restrictions in Europe, such as greater disclosure requirements (see Capital Requirement Directive II, 2009/111/EC, OJ L302, 17 November 2009, P 0097–0119), more onerous capital requirements for securitizations held in trading books (see Capital Requirement Directive III, 2010/76/EU, OJ L329, 14 December 2010, P 0003–0035), more onerous liquidity requirements for residential mortgage-backed securities (RMBSs) than for covered bonds (see Proposal of Capital Requirement Directive IV; European Commission Proposal 20-7-2011, COM(2011) 453 final. For more information on these Directives see http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm accessed 3 March 2013. Capital surcharge under Solvency II Directive (2009/138/EC, OJ L335, 17 December 2009, P 0001–0155) is up to 10 times higher for AAA MBSs than for AAA covered bonds and the European Central Bank requires as collateral at least AA MBSs in comparison of only B- covered bonds (at 208).

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such as investors. There is little transparency in contractual-based securitization. Its performance will depend on private arrangements and the 'opinion' of private agents known as 'rating agencies'.[17] This leads to complicated structures and undisclosed procedures. There is a lack of transparency in relation to the description and identification of the actual securitized assets and their relevant features, how they have been transferred, which law is applicable in case of default of the underlying mortgages, etc. This has contributed to the widespread development of the so-called 'blind trust' crisis, where those taking part in a securitization process relied (often without checking due to the complexity and costs) on the statements of the previous stakeholder in the process. Clearly, investors were even further removed from such enquiries.

In contrast, the covered bonds system promotes more responsible lending, as the originator retains the full default risk of the mortgages and is incentivized to minimize risks and consequent mortgage default.[18] Indeed, it has been estimated that the introduction of an effective covered bond system in the US would decrease the mortgage default rate eight times more than the provision of section 941 of the Dodd-Frank Act, which obliges originators to retain a five per cent credit risk of securitized non-qualifying mortgages on their balance sheets.[19]

Second, the lack of a public standardized MBS in the US was fatal. Covered bond legislation in Germany, Spain, France and other European states creates a standardized type of covered bond for each country. Moreover, these regulated covered bonds fulfil the minimum requirements of Article 52.4 of the UCITS Directive and, because of this, they have some benefits across Europe.[20] The situation in the US has provided the opportunity for private institutions, such as rating agencies, to act as private gatekeepers of this market. Using their ratings and simple final 'marks' (A+, B, etc.), they purport to assess the risk of a specific issue of MBS for international investors. This dependence on such private control would not have been possible or, at least, would not have been so relevant within an effective securities public supervision system. Such a system does not exist in the US.[21] Indeed, rating agencies are not required to assess the 'legal risk' of European covered bonds (although rating agencies do rate them), as the law is public and transparent for everybody. Only those

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17 See below.

18 European Covered Bond Council (n 16) 151.

19 The Dodd-Frank Wall Street Reform and Consumer Protection Act 2010. See Ryan Kreitzer, *Covered Bond Markets: An Analysis of Their Impact on Mortgage Underwriting* (New York, Leonard N Stern School of Business 2012) 46 and 47.

20 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJEU 17 November 2009, L302/32.

21 See Tamar Frankel, 'Regulating the Financial Markets by Examinations' in Mitchell and Wilmarth, Jr (n 15) 219.

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securities that comply with legislative requirements can be called ‘covered bonds’. There is even a ‘denomination protection’. The behaviour of the rating agencies during the boom years has been heavily criticized for their contribution[22] to the financial mortgage bubble. The agencies are culpable, not least through apparently careless ratings of MBSs and CDOs,[23] but also in directly assisting the issuer of these instruments in structuring them in a way which transmogrified subprime loans into Triple A securities. These were, of course, initially attractive for international investors, but were ultimately worthless.[24] Moreover, from 1983 until the introduction of the Dodd-Frank Act in 2010, the rule in s 436(g) of the US Securities Act 1933 prohibited anybody from suing for damages against any of the three biggest rating agencies – Moody’s, Standard & Poor’s and Fitch Ratings. These were termed Nationally Recognized Statistical Rating Organizations (NRSROs). Such a prohibition or immunity from justice should not be acceptable in states that guaranteed the universal right to access to justice. For instance, in Spain, anybody can sue anybody for any reason, according to Article 24 of the Spanish Constitution. After the abrogation of section 436(g) by the Dodd-Frank Act 2010, it seems clear that rating agencies were considered as experts and were not simply giving their ‘opinion’,[25] thus losing the protection of the First Amendment of

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22 Frank Partnoy, ‘Overdependence on Credit Ratings was a Primary Cause of the Crisis’ in Mitchell and Wilmarth, Jr (n 15) 116. See also Lawrence J White, ‘The Credit Rating Agencies’ (2010) 24(2) Journal of Economic Perspectives 218–21: ‘The securitization of these subprime mortgages was only able to succeed … because of the favourable ratings bestowed on the more senior tranches’.

23 Steven L Schwarcz, ’Too Big to Fail?: Recasting the Financial Safety Net’ in Mitchell and Wilmarth, Jr (n 15) 96.

24 Mark Anchor Albert ‘Ratings Wars. The Lawsuit Filed by Calpers May Be Able to Overcome the Rating Agencies’ Traditional First Amendment Defense’ *Los Angeles Lawyer* (October 2009) 38. We mentioned above the concept of the ‘blind trust’ crisis. Paragraph 10 of the introduction of European Regulation 1060/2009, of the European Parliament and of the Council of 16 September 2009, on credit rating agencies (OJ L302/1, 17 November 2009) states that: ‘Credit rating agencies are considered to have failed, first, to reflect early enough in their credit ratings the worsening market conditions, and second, to adjust their credit ratings in time following the deepening market crisis. The most appropriate manner in which to correct those failures is by measures relating to conflicts of interest, the quality of the credit ratings, the transparency and internal governance of the credit rating agencies, and the surveillance of the activities of the credit rating agencies. The users of credit ratings should not rely blindly on credit ratings but should take utmost care to perform [their] own analysis and conduct appropriate due diligence at all times regarding their reliance on such credit ratings’.

25 As was considered the case in many cases, such as J*efferson County Sch Dist v Moody’s Investors Servs* 1999 175 F 3d 848, 856 (10th Cir 1999) and *County of Orange v McGraw-Hill Cos* 1999 245 BR 151, 157 (CD Cal 1999).

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the US Constitution for their ratings.[26] The *CalPERS* case[27] was an example of an institution that incurred losses of about $1,000 million by relying on the rating agencies' representations. In December 2012, the court held that the defendants did not seem to be protected by the First Amendment.

Third, the deficient regulation of the 'US mortgage securitization market' is a major concern. At the end of the day, the assets which are securitized in a mortgage securitization process are mortgages.[28] The strength of a mortgage, and the securities on which it is backed, depends on a pool of factors. Some of these are directly related to the property charged, such as location, building materials, whether the property is a flat or a house, etc. Similarly, the type and features of the mortgage loan involved, such as the LTV, interest rate, etc., are important. However, some key factors are directly related to the legal configuration of the mortgage itself, such as the way in which it is legally structured within a particular legal environment.

It is useful to outline here the details of the so-called 'US mortgage' – the type of mortgage at the base of the chain of any US mortgage securitization process, although it is difficult to talk about a single type of 'US mortgage'.[29] Traditionally, from a legal perspective, there are two basic types: those states, mainly west of the Mississippi river, which follow the lien theory (the creditor has a security interest, but the title is not transferred to him or her) and those states, mainly east of the Mississippi river, which follow the title theory (in which the mortgage title is transferred to the lender).[30] However, other classifications can be made depending on different criteria, such as the way in which mortgages are formalized (regular mortgages between mortgagee and mortgagor, deeds of trust where there is a trustee between both who holds the mortgage title)[31] and

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26 See *New York Times v Sullivan* 376 US 254 (1964).

27 *California Public Employees Retirement Scheme v Moody's Corp et al* CGC-09-49024. See http://dockets.justia.com/docket/california/candce/3:2009cv03628/217999 accessed 17 September 2012.

28 This is true for the US and most countries that allow mortgage securitization, but not, for example, for Spain. See Nasarre-Aznar (n 2) 60–63.

29 Although this expression is the one that is used in response to international investors when they ask for the type of collateral of the MBSs or CDOs they are about to buy, in fact the mortgage pooling is done at the federal level through the agencies, and the rules that govern these mortgages are state or even county-based. Conversely, securitizations organized in Europe are national and it is not common to sell them whilst saying that they are backed by 'European mortgages' as no 'European mortgage' exists.

30 GJ Siedel and Janis K Cheezem, *Real Estate Law*, 4th edn (Boston, MA, South-Western College Publishing 1999) 310.

31 Robert Kratovil, 'Mortgage Law' in Robert H Pease and Homer Virgil Cherrington (eds), *Mortgage Banking* (New York, McGraw-Hill 1953) 24 states that this type can be useful if there are a number of lenders as a trustee acquires mortgage titles (instead of the lenders) who can eventually also foreclose the mortgage instead of the default of the mortgagor.

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others (reverse mortgages, equitable mortgages). But, apart from this, mortgages are registered, conveyed and foreclosed in a different way between states. Indeed, this diversification and lack of common regulations at a federal level[32] contributes to the weakness of an efficient securitization process,[33] especially in those aspects relating to investors' protection.

In relation to registration, there is no common land register in the US, but instead many county equivalents, amounting to some 3,000 registers, following a tradition since the seventeenth century. Each county register has its own requirements, fees, procedures, rules, etc. In fact, they have been defined as 'a terribly cumbersome, paper-intensive, error-prone, and therefore costly process for transferring and tracking mortgage rights'.[34] To attempt to make the system more efficient, title insurance companies maintain copies of the records of the county recorders and assume, through their policies, the risks (mistakes, omissions, etc.) that accompany those records, although this system has its own problems.[35] This wholescale inefficiency in the mortgage registration system was the impetus for the main US mortgage market stakeholders – Fannie Mae, Freddie Mac and the Mortgage Bankers Association of America – to create a private land register in 1995. This would operate alongside, but outside of, the rules of the county registers:[36] a device called Mortgage Electronic Registration Systems (MERS).

MERS performs two functions. It is a private land register for those members of the system where it assumes the role of 'land registrars', as mortgages are transferred within the system. Significantly, MERS also acts as the mortgagee in each recorded mortgage relationship. Remarkably, it is registered in the county register as the mortgagee, even though it is not the lender. Any other operation

32 Grant S Nelson, 'Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law' (2010) 37(538) Pepperdine Law Review 606. Various attempts in the last 90 years at different types of initiatives (e.g. the soft law of the American Law Institute with its Restatement (Third) of Property: Mortgages 1997) have been insufficient to achieve a country-wide mortgage. In Europe, doctrinal works have been carried out through the drafting of a Eurohypothec, a common mortgage for Europe (see Agnieszka Dziecrewicz-Tulodziecka (ed), *Basic Guidelines for a Eurohypothec* (Warsaw, Mortgage Credit Foundation 2005). See also Sergio Nasarre-Aznar, 'Eurohypothec: Drafting a Common Mortgage for Europe' (2010) 2(1) Journal of Legal Affairs and Dispute Resolution in Engineering and Construction 50.

33 Nelson (n 32) 594.

34 Phyllis K Slesinger and Daniel McLaughlin, 'Mortgage Electronic Registration System' (1995) 31 (808) Idaho Law Review 808.

35 Christopher L Peterson, 'Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System' (2010) 78 University of Cincinnati Law Review 1366. From a European perspective, the problem of data protection should be added to those listed by the author, as it is questionable whether private companies can hold and manage the personal data and details of the titles over land.

36 Instead of focusing on trying to push forward a sort of harmonized system, such as the EULIS initiative in Europe: http://eulis.eu accessed 3 March 2013.

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with the mortgage registered in this way is not public and does not alter the county register,[37] but operates within the MERS system. It should be noted that MERS is directly operated by the members involved in each transaction[38] and is a unique system for the whole country. Two-thirds of the mortgages originating in the US are contained within MERS, amounting to approximately 60 million mortgages in 2007.[39] In many ways, the MERS system distorts the character of an ideal land registry system, which should be public, accessible by everybody, controlled by the public administration and controlling the validity of the recorded titles. Indeed, it has created a range of new problems, where, among other issues, it claims to be the mortgagee and also the enforcer of the default arrangements, but not the lender. Of course, this leaves the mortgagor unprotected, since it is clearly inappropriate that the enforcer of the security in the mortgage is not the lender under the mortgage loan arrangement. Several court resolutions have stated that MERS cannot enforce the mortgage as it does not hold the promissory note (technically it does not have a claim),[40] which probably has remained in the hands of the originator of the mortgage.[41] Thus, it may be the case that MERS is contributing to the poor identification of liabilities arising from the predatory lending process.[42] This may be related to the 'robo-signing' scandal, involving the forging of false documents evidencing the transfer of promissory notes to the bank purported to foreclose the mortgage.[43] In December 2011, the Massachusetts Attorney General filed the first major state lawsuit over 'robo-signing' against several major banks and MERS.[44] The Attorney General alleged that these five entities:

> engaged in unfair and deceptive trade practices in violation of Massachusetts law by pervasive use of fraudulent documentation in the foreclosure process, including

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37 This remains recorded with MERS as 'mortgagee'. This allows the mortgage industry to use MERS to evade paying the fees and taxes related to mortgage transactions. See Peterson (n 35) 1362.

38 This leads to new problems, such the one raised in *Deutsche Bank National Trust Co v Maraj* 2008 NY Slip Op 50176 (U) (NY Sup Ct Kings Co).

39 Peterson (n 35) 1362 and 1373.

40 See National Consumer Law Center, *Foreclosures* (4th edn, Boston, MA, National Consumer Law Center 2010) 143. See also the decision in *Johnson v Home State Bank* 501 US 78, 111, S Ct 2150, 2154, 115 L Ed 2d 66 (1991).

41 In fact, it is MERS itself that alternately presents itself as a mere agent of the mortgagee (when it is sued for fraud, bad practice or violation of consumers' rights) or as a mortgagee (when tries to foreclose a mortgage). See, in this sense, Peterson (n 35) 1376.

42 ibid, 1399.

43 'Mortgage Mess: Who Really Owns Your Mortgage' *Sixty Seconds* (3 April 2011) http://www.cbsnews.com/video/watch/?id=7361596n accessed 19 July 2013.

44 *Commonwealth of Massachusetts v Bank of America et al* (Superior Court Depatment of the Trial Court 11-4363, 1 December 2011) http://www.mass.gov/ago/news-and-updates/press-releases/2011/five-national-banks-sued-by-ag-coakley.html accessed 29 October 2012.

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> so-called 'robo-signing', foreclosing without holding the actual mortgage, corrupting [the] Massachusetts land recording system through the use of MERS, and failing to uphold loan modification promises to Massachusetts home-owner.[45]

In relation to this, JP Morgan, Bank of America, Citigroup, Ally Financial and Wells Fargo & Company were accused of faulty foreclosure practices. However, in 2012, a settlement was reached with the Department of Justice, the Department of Housing and Urban Development and 49 states, through which the lenders were given immunity from prosecution for this cause in exchange for direct compensation ($25 billion) to home-owners who were at risk of foreclosure or who had already been foreclosed.

Thus, the system of mortgage transfer in the US is in jeopardy, giving rise to questions concerning the credibility of the whole US mortgage securitization process. This situation creates major risks for US MBS holders. It is remarkable that only now, after 40 years of US mortgage securitization, is there an active discussion in the US on how mortgages can be properly transferred as an essential step in any standard US securitization process. This discussion is taking place at a number of levels: in the report of the Permanent Editorial Board for the Uniform Commercial Code 2011;[46] regarding the differences in the transfer of regular mortgages and deeds of trust;[47] among authors who have evidenced sharp differences among different systems;[48] within the mortgage industry itself;[49] and in the courts, such the decisions in *Ibanez* and *Bevilacqua.*[50]

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45 'First Major State Lawsuit Filed Over "Robo-Signing"' *CNBC* (1 December 2011) http://www.cnbc.com/id/45511868 accessed 15 March 2013.

46 The Permanent Editorial Board for the Uniform Commercial Code, 'Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes' 14 November 2011. The American Law Institute and the National Conference of Commissioners on Uniform State Laws (14 November 2011) establishes a set of four rules on the basis of the Uniform Commercial Code, but it says that: 'The enforcement of real estate mortgages by foreclosure is primarily the province of a state's real property law.'

47 See National Consumer Law Center (n 40) 145; and *Landmark National Bank v Kesler*, 216 P 3d 158 (which establishes that separating interests of note and deeds of trust can leave the mortgage unenforceable).

48 Nelson (n 32) 591 and 592.

49 See the discussion of the report of the American Securitization Forum, 'Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market' ASF White Paper Series (16 November 2010).

50 The first case is *US Bank National Association v Antonio Ibanez, Supreme Judicial Court of Massachusetts*, 7 January 2011 (458 Mass 637), in which the Court stated that: 'In Massachusetts, where a note has been assigned but there is no written assignment of the mortgage underlying the note, the assignment of the note does not carry with it the assignment of the mortgage. *Barnes v Boardman* 149 Mass 106, 114 (1889). Rather, the holder of the mortgage holds the mortgage in trust for the purchaser of the note, who has an equitable right to obtain an assignment of the mortgage, which may be accomplished

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It is worth mentioning the relevant inefficiencies (delays and losses) of the mortgage enforcement systems in the US that directly affect the capacity for lenders to recover the money they have lent, and therefore the capacity of investors in MBSs to recover the money they have invested in those securities. The average time to process a foreclosure in the US increased from 253 days in 2007 to 674 days in 2011, although the duration is about three years in Florida, Washington and New York.[51] Mortgage foreclosure law differs from one state to another.[52] In 40 per cent of states, it is only possible to start a judicial foreclosure, which is a long, complex, expensive and inefficient system.[53] If the lender finally succeeds in foreclosing, the inefficient auction process involving the sheriff does not facilitate a proper sale of the property based on its market price – a system which causes losses to the lender that may affect the stability of the securitization structure in which that particular mortgage was included. Second, those states in lighter grey in Figure 2.2 are non-recourse states – where the mortgagee is only secured with the charged property and not with the rest of the estate of the mortgagor. The possibility of mortgage default can be up to 81 per cent higher in these compared with recourse states.[54] This has given rise to the phenomenon of the 'strategic defaulter' – those mortgagors who can pay the mortgage, but since their property is worth less than the money they still owe to the lending institution, they simply 'walk away', giving the lender the keys of the property.[55]

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by filing an action in court and obtaining an equitable order of assignment.' In the praxis this means that thousands or even millions of mortgages are unenforceable (and therefore the MBSs issued over them depreciated greatly or simply defaulted as they were often structured over closed pools of mortgages) unless mortgagees acquire all those notes or 'forge' them through robo-signing because they did not exist at all. The second case is *Bevilacqua v Rodriguez*, Supreme Judicial Court of Massachusetts, 18 October 2011 (460 Mass 762), which confirmed that the mortgage holder must have a valid assignment of mortgage to foreclose a property.

51 Les Christie, 'Foreclosure Free Ride: 3 Years, No Payments' *CNN Money* (28 December 2011) http://money.cnn.com/2011/12/28/real_estate/foreclosure/index.htm accessed 18 September 2012.

52 Nelson (n 32) 586.

53 Prentiss Cox, 'Foreclosure Reform Amid Mortgage Lending Turmoil: A Public Purpose Approach' (2008) 45 (3) Houston Law Review 699; see also Nelson (n 32) 586.

54 Ghent and Kudlyak (n 10) 29. See also Kreitzer (n 19) 46 and 47.

55 Moreover, there is a plethora of techniques available to the borrower to delay the foreclosure, such as filing for bankruptcy, staying at home during foreclosures, equity skimming, etc. Other arrangements with the lender, such as deeds in lieu, short sales or conciliations, also affect the secondary mortgage market as they usually entail a loss to the lender, which is transferred to the MBS investors if that mortgage was included in a backing pool.

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Figure 2.2 Recourse (dark grey) and non-recourse (light grey) states.
Source: own elaboration [56]

Thus, it is questionable whether the inefficiencies in ‘US mortgages’ were already known by investors at the time they bought US MBSs and CDOs, or whether they were being taken into account by rating agencies when they were giving ‘Triple A’ ratings to those mortgage-collateralized MBSs and CDOs. All this evidences a significant level of distortion[57] of the legal system and generalized reckless practices in the origination, transfer and enforcement of mortgages in the US. This has clearly contributed to the failure of the international financial system and the globalization of the crisis.

From the International Crisis to the Detrimental Impact on the Spanish Housing System

In 2009, global losses in the international banks and other financial institutions arising from US-originated assets were estimated at approximately $2.7 trillion.[58] In Europe, three major British banks lost $31.8 billion, two major Swiss banks

56 Using the data of Ghent and Kudlyak (n 10) 44 and 55.

57 On this concept, see Steven L Schwarcz, ‘Distorting Legal Principles’ (2010) 35(4) Journal of Corporation Law, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532465 accessed 18 September 2012.

58 International Monetary Fund, ‘Global Financial Stability Report (GFSR)’ (April 2009) 11 http://www.imf.org/external/pubs/ft/gfsr/2009/01/pdf/text.pdf accessed 18 September 2012.

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lost $62.3 billion, and $41.1 billion was lost by three major German banks up to December 2008, – all traceable to the US subprime crisis.[59] These losses heavily affected the capital position of the banks, which entered a liquidity crisis. The securitization market dropped dramatically, as did interbank lending, due to the general lack of trust between financial institutions. In some countries, such as Spain, banks almost completely ceased lending to families or businesses, thus virtually halting the economy. It is significant that in 2007, loans (mostly mortgage loans) represented about 65 per cent of the Spanish banks' balance sheets.[60]

Indeed, the Spanish economy and financial system has performed even worse than would be expected during a globalized crisis, particularly when compared to the impact in the majority of EU countries. Although many causes could have contributed to this, it is suggested that the last housing boom/bubble (1995–2007) is one of the most relevant. In a manner similar to the US pattern described above, the promotion of widespread home-ownership at any cost, combined with the speculative or the buy-to-let business approach, has been prevalent in Spain and other European countries. Spanish housing policy, before and during the housing bubble, involved massive construction and enormous levels of mortgage loans, which has now led to an over-indebted society.[61] This was facilitated by ready access to mortgage credit as a result of low interest rates and the liquidity of Spanish banks, which benefited from a good interbank lending system (based on trust among banks), and the massive issuing of Spanish covered bonds and MBSs. In fact, Spanish banks had for many years been the second largest issuer of covered bonds and MBSs after Germany (covered bonds), and the UK (MBSs).[62] Other countries such as Ireland experienced similar policies and a housing market collapse on a similarly large scale.[63]

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59 Cox, Faucette and Valenzuela (n 6) 18.

60 Ibid.

61 For numbers, see below.

62 See Sergio Nasarre-Aznar, 'Operaciones pasivas. La refinanciación de créditos y préstamos hipotecarios' in Esther Muñiz Espada, Sergio Nasarre-Aznar and Elena Sánchez Jordán (eds), *La reforma del mercado hipotecario* (Madrid, Edisofer 2009) 399–552, but especially 406–12, where the bad performance of Spanish covered bonds when compared to other European covered bonds since the beginning of the crisis is discussed.

63 At least three authoritative reports on the Irish financial crisis have highlighted massive overlending, which overheated the housing market. See Klaus Regling and Max Watson, *A Preliminary Report on the Sources of Ireland's Banking Crisis* (Dublin, Government Publications Office 2010); Commission of Investigation into the Banking Sector in Ireland, *Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland* (March 2011), known as the Nyberg Report; Governor of the Central Bank, *The Irish Banking Crisis. Regulatory and Financial Stability Policy 2003–2008* (Dublin, The Stationery Office 2010). This latter report shows that by 2006, the increase in construction and housing had increased beyond population needs, reflecting speculative purchases that represented 15 per cent of the housing stock that stood vacant. But it also says (at 30) that taxation incentives aimed at the construction sector, e.g. lowering stamp duty five times

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However, in Spain, the situation was more severe as a consequence of the unavailability of a *real* alternative housing tenure to home-ownership. For years, the Spanish housing rented sector remained one of the smallest in Europe (see Figure 2.3), which in practice meant that it was of poor quality and relatively expensive.[64] All tax benefits were targeted at home-owners rather than tenants/lessees. There was an inefficient eviction process for rented properties, which compared poorly with an efficient (but very lender-oriented) mortgage enforcement procedure. State housing plans revolved around build-to-sell rather than a renting-what-is-already-built-oriented approach. Market advantages, in the form of structured and funded mortgage facilities, have overshadowed an undeveloped rented market, while Spanish legislation over the past 60 years focused on the needs of banks and home-owners rather than lessors and lessees. The result is that, even today, only about 15 per cent of households occupy rented housing and only two per cent occupy social rented housing. Thus, there is still no real (in terms of affordability, quality, stability, etc.) alternative to home-ownership for families, which is an issue in many other European states .[65]

In fact, since the beginning of the financial crash in the last quarter of 2007 (and the subsequent mortgage and housing crisis), Spanish economic stability[66]

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between 2001 and 2007 to improve the affordability of houses to first-time buyers and special schemes, existed for many types of constructions. Moreover (at 31), the ceiling on the income tax deductibility of mortgage interest for owner-occupiers was increased four times between 2000 and 2008. See also P van den Noord, 'Tax Incentives and House Price Volatility in the Euro Area: Theory and Evidence', OECD Economics Department Working Papers No 356, 2011, 9, which clearly stated that the tax system was subsidizing housing in Ireland and Spain (among others).

64 See a complete discussion in Sergio Nasarre-Aznar and Estela Rivas Nieto, 'La naturaleza jurídico-privada y el tratamiento fiscal de las nuevas sociedades cotizadas de inversión en el mercado inmobiliario (SOCIMI)' en la Ley 11/2009 Estudios Financieros. Revista de Contabilidad y Tributación, 2009 DIC; (321); and D Rae and P van den Noord, 'Ireland's Housing Boom. What Has Driven it and Have Prices Overshot?' OECD Economics Department Working Papers No 492, 6.

65 See a complete discussion of this in Montserrat Pareja Eastway, 'El régimen de tenencia de la vivienda' in Jesús Leal (ed), *La política de vivienda en España* (Madrid, Ed Pablo Iglesias 2010) 101.

66 Which has been recently (2011–12) replicated into a political crisis (e.g. the form of state divided into autonomous regions since 1978 is in question, with Catalonia's current government requesting the independence from the rest of Spain (see http://www.nytimes.com/2012/10/06/world/europe/in-catalonia-spain-artur-mas-threatens-to-secede.html?partner=rss&emc=rss&smid=tw-nytimes&_r=0 accessed 6 October 2012) and serious social unrest (e.g. just in the main city of Spain, Madrid, there have been 983 demonstrations between July and September 2012 (see 'Las manifestaciones pasan factura a Madrid' *LaVanguarida* (27 September 2012) http://www.lavanguardia.com/local/madrid/20120927/54351933893/las-manifestaciones-pasan-factura-a-madrid.html accessed 6 July 2013.

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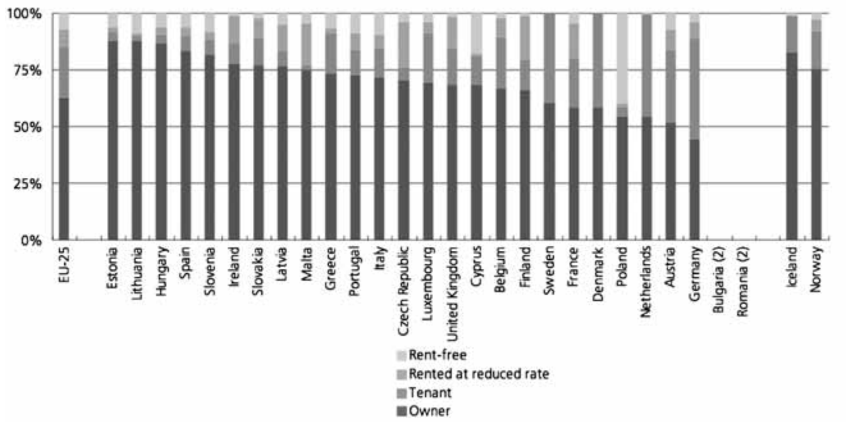

Figure 2.3 Number of dwellings by type of tenure in Europe, 2009.
Source, Eurostat.

itself has been in constant danger.[67] This has had an important impact on housing. The following data outlines the current situation of housing in Spain after five years of economic crisis:

1. From 2007 to 2011, there have been 330,000 mortgage foreclosures.[68] Paradoxically, the new census of 2011 reveals that there are 3.5 million empty dwellings.[69]
2. Mortgage funding and house sales are still decreasing – down by 29.3 in 2011 compared to 2010.[70]

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67 The massive banking reforms through mergers and acquisitions and nationalization, the current lack of liquidity of Spanish banks that remain untrustworthy in international business, the 'intervention' of the EU in the Spanish economy in July 2012, the creation of a 'bad bank' with thousands of unsold properties at bargain prices, the sovereign rate risk that exceeded 600 basic points in relation to Germany in July 2012 and the cuts in workers' salaries and other social rights are only some examples of the elements of the drama.

68 Consejo General Del Poder Judicial, 'Datos sobe el efecto de la crisis en los órganos judiciales 3T 2011' (Madrid, 2011) www.poderjudicial.es accessed 19 July 2013, under 'Estadística'. However this data does not differentiate between first residences and other dwellings or even between dwellings and other type of properties.

69 See, however, Juan Carlos Martinez, 'En España un 20 per cent de las viviendas están vacías' *El Pais Economia* (8 May 2012) http://economia.elpais.com/economia/2012/01/05/actualidad/1325752378_850215.html accessed 18 September 2012.

70 Statistics can be found at the website of the Ministerio de Fomento http://www.fomento.gob.es/BE2/?nivel=2&orden=34000000 accessed 18 September 2012.

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3. Some 5.7 million people were unemployed in July 2012, an employment rate of 24.63 per cent.[71] This has a significant influence in the increasing number of defaulted (mortgage) loans.
4. According to *The Economist* (9 February 2012), on the basis of unemployment and inflation ratios, Spain is currently the sixth poorest country out of a list of 92.[72] According to UNICEF, some 2.2 million children in Spain are living in families below the poverty threshold.[73]
5. According to Eurostat, some 37 per cent of the Spanish population between 18 and 35 consider access to a dwelling as one of the most important problems facing Spanish youth[74] and as the main cause of why children are not leaving their parents' house until they are 30 years old.[75] Even then, some 30 per cent still need economic support from their parents or other relatives.[76]

There are at least four legal factors which, in my opinion, contribute to an understanding of the current situation of Spanish housing and mortgage markets, and which bear similarities to factors in the US that caused the crisis.

First, bad banking practices are a major contributory factor. For many years, Spanish banks undertook bad practices by offering inadequate products,[77] including those related to their mortgage loans. Subprime mortgages were also a reality in Spain during the housing bubble. Lenders granted mortgages of even more than 100 per cent LTV, regardless of the capability of the borrower to pay

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71 According to the Instituto Nacional de Estadistica (INE): http://www.ine.es/jaxi/menu.do?type=pcaxis&path= per cent2Ft22 per cent2Fe308_mnu&file=inebase&L=0 accessed 18 September 2012.

72 'Feeling Gloomy' *The Economist* (9 January 2012) http://www.economist.com/blogs/graphicdetail/2012/01/daily-chart-0 accessed 18 September 2012.

73 UNICEF, 'La infancia en España 2012–2013. El impacto de la crisis en los niños' (May 2012) 8 http://www.unicef.es/sites/www.unicef.es/files/Infancia_2012_2013_final.pdf accessed 17 September 2012.

74 Centro de Investigaciones Sociológicas (CIS), 'Estudi 2835' (27 April 2010) http://www.cis.es accessed 18 September, 2012.

75 Eurostat, 'Youth in Europe. A Statistical Portrait' (2009) 31 http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-78-09-920/EN/KS-78-09-920-EN.PDF accessed 18 September 2012.

76 Fundacion Encuentro, 'Informe España 2011. Una interpretación de su realidad social' (2011) 191 http://www.fund-encuentro.org/ accessed 19 September 2012.

77 As an example, the Spanish Securities Exchange Commission (Comisión Nacional del Mercado de Valores) has established fines for 10 credit institutions for commercializing a kind of security called 'preferred participations' (*participaciones preferentes*) without explaining them properly to their clients, and thus failing to fulfil the Markets in Financial Instruments Directive requirements to obtain a proper consent from them: http://economia.elpais.com/economia/2012/09/13/actualidad/1347528967_278279.html accessed 13 September 2012.

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the instalments under the mortgage.[78] The careless examination of the repayment capability of the borrower led, according to the Bank of Spain, to a delinquency rate of housing mortgage loans of 3.22 per cent in mid-2012, up from 1.31 per cent in mid-2008.[79] The risk to banks was usually covered by requiring borrowers to find a friend or a relative to mortgage their own dwelling, or even provide a personal guarantee (*aval*) with their whole estate for the repayment of the mortgage loan. This practice has contributed to the extension of the housing crisis among families of all income levels.[80] Similarly, for years, Spanish banks had sold risky financial products to both small corporations and consumers. These were arranged with corresponding credit default swaps, to stabilize the volatility of the variable interest rate of their mortgage loans (referenced to the Euribor index)[81] or to provide a floor clause within the mortgage loan contract terms. These types of financial products were commercialized just a few months before the biggest drop of the Euribor in its history[82] and some months after the first effects of the credit crunch in Spain.[83] Many of those contracts were worded in an obscure manner for clients. The reference indexes were imposed by the banks (a fixed reference index of around 4.5 per cent), which, in practice, meant that since October 2008, clients have been paying extra over and above their mortgage instalments to the banks on a monthly basis. This is the typical obligation resulting from an interest rate swap or a floor clause, as the Euribor has remained since then lower than those 'agreed' reference indexes.

Moreover, customers/clients found it very difficult to assess the real legal and economic consequences of underwriting those contracts, as neither neutral nor complete information was provided to them. There was no legal requirement to ensure that customers/clients understood all the details of the arrangement, demonstrating the major asymmetry of information between the parties. Banks could have reasonably been expected to have known in advance that the Euribor rate would drop significantly, or were at least more likely to do so than the

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78 Since 2002, banks have been legally allowed to securitize Spanish subprime mortgages through the issue of Spanish asset-backed securities (ABSs) (*bonos de titulización de activos*). This meant that Spanish banks were allowed to get rid of problematic mortgages as soon as they were granted and therefore they had no problem in granting them to families and people who were unable to repay them.

79 It is about 25 per cent for mortgage loans granted to builders. See Asociación Hipotececaria Espanola, 'Tasas de dudosidad hipotecaria, Segundo Trimestre 2012' (2012) http://www.ahe.es/bocms/images/bfilecontent/2006/04/26/90.pdf?version=17 accessed 6 October 2012.

80 'Las ejecuciones hipotecarias amenazan ya a las familias de las zonas de rentas altas' *El Mundo* (24 September 2012) http://www.elmundo.es/elmundo/2012/09/24/suvivienda/1348478744.html accessed 9 September 2012.

81 'EURIBOR' (the Euro Interbank Offered Rate) is the money market reference rate for the euro.

82 October 2008.

83 September 2007.

consumers or small businesses with whom they made such arrangements. The courts have reacted to this situation by declaring many hundreds of swaps, caps, floor clauses and similar financial derivative agreements void.

It is significant that the transposition of the Markets in Financial Instruments Directive (MiFID)[84] into Spanish law arrived late, in 2008, when all banking activity had already virtually stopped. Although now implemented, its application has been disappointing for non-professional customers. Indeed, non-professional customers can still engage in contracts associated with the vast majority of risky financial products, even where the non-professional customer has not passed the adequacy or convenience test. This, in practice, means that he or she does not know what he or she is contracting, and is bound just by signing that he or she agrees to the contract (even if he or she does not understand it and/or its consequences). Conversely, banks are using these tests as a defence against claims from consumers to demonstrate that they had properly assessed them, and that the customers wished to enter into contracts for these products, even if they did not understand them.[85]

Spanish legislation has allowed and even promoted new forms of risky banking practices, even in the delicate field of housing. In this sense, the reform of the mortgage market in Spain, by Act 41/2007,[86] introduced two new risky

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84 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJEU, 30 April 2004, L145/1).

85 This is a similar criticism noted in C Castronove, 'Information Duties and Precontractual Good Faith' (2009) 4 European Review of Private Law 568 of consumers' protection through long lists of pre-contractual information to be provided by the professional seller before an arrangement (see, as an example, the 20 pieces of pre-contractual information to be provided in distant contracts according to art 6 of Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, OJEU 22 November 2011, L304/64). Basically, consumers do not read all this information on a regular basis and, even if they do so, in some cases they may not fully understand it, thus evidencing that there is not necessarily a correlation between more pre-contractual information and more consumer protection. For criticism of this system, see T Sefton Green, *Mistake, Fraud and Duties to Inform in European Contract Law* (Cambridge University Press, 2009) 398. See also research on this in the US in O Ben-Shahar and CE Schneider, 'The Failure of Mandated Disclosure', Chicago Working Paper Series Index (March 2010) 64, where it is shown that the history of compulsory provision of information 'is a history of failure'. See also F Marotta Wurgler, 'Will Increased Disclosure Help? Evaluating the Recommendation of the ALI's "Principles of the Law of Software Contracts"' (2011) 78 (1) University of Chicago Law Review 165

86 Spanish Act 41/2007, 7 December, which modifies Act 2/1981, 25 March, of regulation of the mortgage market (BOE 8 December 2007, no 294, 50593).

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practices that were discouraged by the European Commission White Paper on the Integration of EU Mortgage Credit Markets.[87] The first of the two is related to the tying practices, i.e. banking practices that make it more difficult for the borrower to change his or her lending institution because of the costs or the numerous links with the existing lender. Thus, while Act 41/2007 limited the effects of former Article 2 of Act 2/1994 on subrogation and modification of mortgage loans,[88] from 2007 onwards, as soon as the borrower receives an offer from a new lender, he or she cannot change if the existing lender matches this offer. Significantly, Objective 3.4 of the European Commission White Paper 2007 strongly discourages the establishment of such limitations on borrowers in Europe.[89] Moreover, Article 9 of the Report of the Economic and Monetary Affairs Committee[90] of the European Parliament clearly states that countries should forbid these tying products. Surprisingly, however, Article 18 of the same Report foresees a similar outcome to the one in Spanish Act 41/2007, which is not desirable as it is contrary to the EU principle of freedom of movement of people and is against free competition among lending institutions in Europe, freedom of choice and consumer mobility.

A second paradox arises in the context of the Commission's caution in the White Paper in respect of equity-release products, such as the reverse mortgage. Yet, these type of products are legally backed in Article 18 of the Report of the Economic and Monetary Affairs Committee and the reverse mortgage was introduced for the first time into Spanish law by Additional Disposition 1 of Act 41/2007. As an example of this approach in Spain, Figure 2.4 shows the 'recommended' way in which a person's life can be linked to a single lending institution. First the lender grants a mortgage loan to buy the first family dwelling when the borrower is in his or her mid-twenties; then it grants consumer loans when the borrower has partially repaid the mortgage loan and he or she is between his or her mid-forties

87 White Paper on the Integration of EU Mortgage Credit Markets, COM(2007) 807 final.

88 BOE 4 April 1994, no 80, 10364.

89 Consumer mobility is a clear-cut objective of the White Paper to achieve a true European mortgage market. In this sense, it says (at 5) that: 'Information alone cannot, however, facilitate customer mobility. By increasing switching costs, "tying" practices (e.g. obliging the consumer to open a current account or take out an insurance policy with the same company when purchasing a mortgage credit) effectively bind consumers to a particular financial services provider, thus restricting mobility and weakening competition. Practices such as obliging consumers to transfer their salary to the current account attached to the mortgage credit may have a similar effect. These practices not only have implications for customer mobility but can also reduce price and product competition in the markets for the tied and tying products and discourage the entry of new players, particular those providers specialising in the tied product.'

90 'Home Loans: Better Advice for Borrowers, More Stable Markets for Lenders', press release, Committee of Economic and Monetary Affairs (7 July 2012) http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+IM-PRESS+20120604IPR46265+0+DOC+XML+V0//EN&language=EN accessed 9 September 2012.

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and mid-sixties; and finally it grants equity-release products when the borrower retires. This form of continuous dependency on the same financial institution means that it is too onerous or complicated to change the lending institution. From 25 years to death (where the reverse mortgage operates), this process even links the borrower's heirs to the lender, since the heir must decide whether to repay the parent's reverse mortgage (perhaps with another mortgage loan) or allow the family home to be sold or be given to the lender.

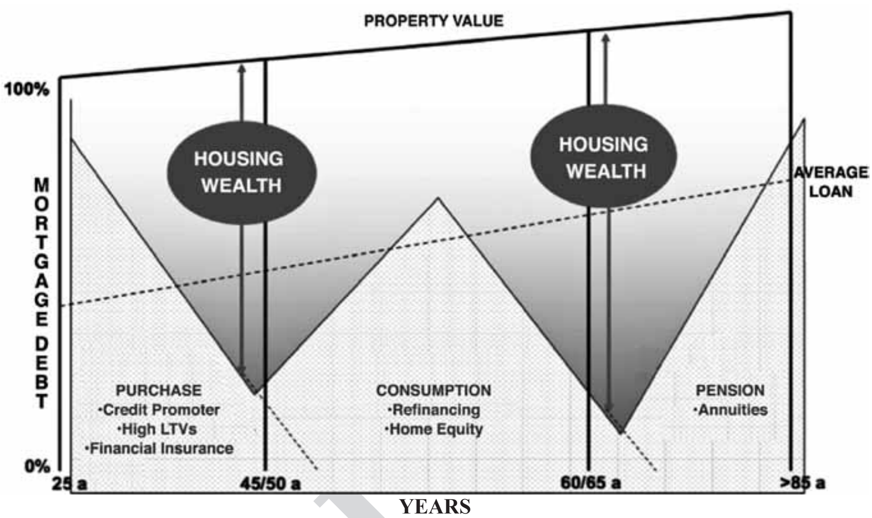

Figure 2.4 'Useful' life of an immovable versus indebtedness (literal translation from the original title)[91]

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In relation to mortgage procedural law, the Spanish mortgage enforcement system and insolvency system is one of the most lender-oriented in Europe. The former has not traditionally allowed the borrower as a consumer to raise any defence in relation to abusive clauses (Articles 695 and 698) that may be present in the loan contract, an approach which does not seem reasonable.[92] A request to the European Court of Justice to determine whether the system foreseen in Spanish

91 Santos Gonzalez Sanchez, 'Presente y futuro del negocio hipotecario' a handout of a paper given at the *Curso de crédito hipotecario* conference (Barcelona, Universidad Rovira i Virgili 2008).

92 According to art 83 RDL 1/2007, they are void and can render the whole loan contract ineffective. In this case, the ineffectiveness of the loan contract will affect the mortgage validity that secures that loan contract, thus making it void. This is because Spanish mortgages are legally dependent on the credit they secure (legal accessoriness).

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law conflicts with European consumer law[93] has been recently decided (in *Aziz v Catalunya Caixa*),[94] where it has been stated that this situation goes against EU law (Directive 93/13/CEE).[95] thus forcing the Spanish government to reform the law (Act 1/2013, 14th May[96]) and causing the suspension of hundreds of mortgage enforcement procedures. Moreover, the mortgagee can, in the same procedure, take action against the rest of the estate of the consumer after an unsuccessful auction of the mortgaged property (Article 579 LEC), a situation that is not the case in many European countries.[97]

Moreover, the Spanish insolvency legislation does grant any second opportunity to 'start again' for an 'insolvent in good faith'[98] natural-person borrower after an insufficient/unsuccessful insolvency process. In contrast, many other European jurisdictions offer more lenient insolvency consequences for natural-person borrowers or consumers, as is shown is Figure 2.5.[99] A timid reform on this field has not arrived until art. 21 Act 14/2013, 27 September[100], to promote entrepreneurship.

To further demonstrate the lender-oriented nature of Spanish law, it is notable that one of the most relevant problems for the Spanish insolvency procedure is the opacity of the auction of the immovable property. Quite often, only professional auctioneers attend these auctions, which often end without any offer. In this case, the property is assigned to the lender, thus bypassing the historical prohibition of the *pactum commissorium* (Article 1859). This makes it more difficult to achieve the real price of the property, a situation detrimental to the borrower, since he

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And this is precisely the mechanism that cannot be discussed – because of legal constraints – during a mortgage enforcement procedure, which of course affects the rights of consumers.

93 OJEU 12 November 2011, C 331/7.

94 Case C-415/11.

95 Directive 93/13/CEE of 5 April 1993 on unfair terms in consumer contracts (OJEC L095, 21 April 1993).

96 BOE 15 May 2013, no 116, 36373.

97 See the whole discussion for both aspects in Sergio Nasarre-Aznar, 'Malas prácticas bancarias en la actividad hipotecaria' (2011) 727 Revista Crítica de Derecho Inmobiliario 2721–23.

98 'Bona fide insolvent' is quite a difficult concept, but basically means that such a person has not put himself or herself negligently into insolvency, that he or she has always collaborated with his or her creditors to try to solve his or her case, and that he or she has not hidden goods or has not lied to the judge or to the insolvency trustees.

99 Figures 2.5 and 2.6 are the result of an intensive research task undertaken by more than 30 researchers from around Europe and Japan, led by Dr Otmar Stöcker (VdP), since 2005 on mortgage law in Europe in the so-called 'Runder Tisch'. The latest versions of the maps can be found in M Stocker Otmas and Rolf Sturner, *Flexibilität, Sicherheit und Effizienz der Grundpfandrechte in Europa Band III*, 3 erweiterte Auflage, Band 50 (Berlin, Verban Deutscher Pfandbriefbanken 2012).

100 BOE 28 September 2013, no 233, 78787.

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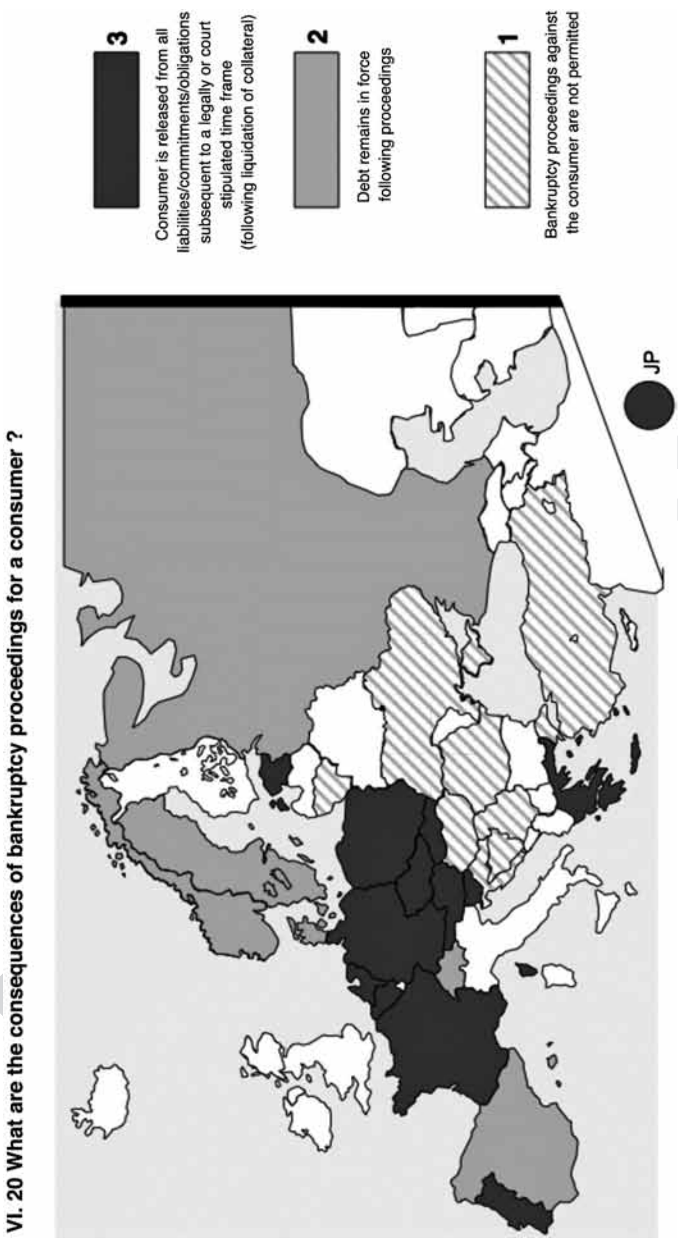

Figure 2.5 The insolvency process against consumers in Europe.
Source: Runder Tisch, 2012.[99]

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Figure 2.6. Minimum advertising of an auction in order to facilitate maximum publicity. .
Source: Runder Tisch, 2012.[99]

or she remains a debtor for life[101] for the amount of the loan not covered by the amount obtained by the sale of the house.[102] As shown in Figure 2.6[99], Spain is one of the very few countries in Europe (together with Belgium and Bosnia) which requires that only an announcement on the physical noticeboard of the court where the auction is going to take place is adequate publicity for a mortgaged property auction. Clearly, this is insufficient for an open, transparent international property market. A sort of system of auctions resulting from mortgage enforcements is foreseen in Act 1/2013, although it still needs to be developed through regulations to exist in the praxis.

Finally, Spain still has inadequate regulation of the mortgage securities. Spanish covered bonds (*cédulas hipotecarias*) and MBSs (*bonos de titulización hipotecaria*) are insufficiently regulated under Spanish mortgage market legislation. As this has been developed in depth elsewhere,[103] just two remarks are necessary here. The first is that the security of Spanish covered bonds for investors is unclear and comparatively insufficient, and their performance in cases of insolvency of the issuer is below the standard of the securities in other European jurisdictions. For instance, no separate estate is created in the case of insolvency of the originator/issuer that may allow the continuation of a healthy covered bonds business. The second is that the legal construction of Spanish MBSs is insufficient, from a civil law point of view, to assure that the SPV (issuer) is an insolvency-remoteness entity, and the rights of MBS holders, in case of mismanagement by any stakeholders, are weak and unclear. This lack of legal certainty contributes to the international lack of trust towards Spanish banks and Spanish mortgage-related financial products. Despite this, no reform is foreseen in the short term in this area, although it would be highly desirable.

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101 For a number of situations, however, this is more a theoretical than a real situation as the RDL 8/2011, 1 July (BOE 7 July 2011, no 161, 71548), has increased the mortgagor's minimum unforeclosability threshold (i.e. the part of the monthly income of a mortgagor that cannot be foreclosed by the mortgagee). In a standard case in 2012, it has risen from about €642/month (Art 607 LEC) to €962/month. Moreover, it is quite theoretical that a bank will be able to recover the owed amount after a partially unsuccessful auction of the borrower's main residence, as it is likely that he or she has no more valuable goods and will not have any for many years. Therefore, the 'recourse' to the rest of the estate of the borrower acts more as a preventive and deterrent measure than as a real way for the lender to recover the rest of the money.

102 This has led to social movements to push legislative changes in Spain in favour of the introduction of a forced *datio pro soluto*, which, in case they succeed, would convert Spain into a form of 'non-recourse' state. As seen above in the case of the US, this does not seem to be a good solution for any mortgage market.

103 See Nasarre-Aznar (n 2) 58. The problems addressed there were not solved in the reform of Spanish mortgage securities in 2007, as is explained in Nasarre-Aznar (n 62). For a summary, see also Nasarre-Aznar (n 96).

Insufficient Reforms in the Spanish Mortgage and Housing Markets

The Guidelines for a New Situation

In relation to the Spanish situation, a number of appropriate reforms, based on the preceding analysis, can be suggested:

1. Measures should be taken to avoid a repetition of any of the following circumstances that led Spain to the current situation: the easy access to credit regardless of mortgagors' resources or repayment capacity; the absence of any real alternative to home ownership; the promotion of the social value of massive consumption[104] and a pro-lender and weak mortgage securities legislation. All of these contributed decisively to the creation of the mortgage and housing bubble in Spain.
2. The choices for families should not be either over-indebtedness due to home-ownership or the lack of stability that results from renting a house in Spain. Yet, even today, access to home-ownership automatically involves over-indebtedness, since salaries in recent years have not increased at the same rate as house prices. In June 2012, five years after the collapse of the mortgage and housing market in Spain and internationally, house prices remain as high as in 2005, one year before the peak of the housing bubble. Even in the rental sphere, there are few signs of improvement. The Spanish government has recently passed Act 4/2013, 4th June[105] to reform the Spanish law on urban leases (*Ley de arrendamientos urbanos*: LAU). This reform brings even less stability to tenants. For example, there is a reduction in the protection period from five to three years, the legal right of pre-emption for the tenant is removed and referenced prices during the protection period is removed. Clearly, this will not increase the attractiveness of renting as a type of housing tenure for families.
3. Mortgagors, and consumers in general, should be able to calculate, from the very beginning of a mortgage agreement, the costs of the mortgage they are about to sign. Equally, mortgagors should be aware of the risks that this might entail. Spain lacks specific protective legislation for mortgagors (as consumers), and these consumers are even explicitly excluded from regular consumer protection laws.[106] The rules foreseen

104 See Jim Kemeny, The Myth of Homeownership. Private vs Public Choices in Housing Tenure (London, Routledge & Kegan Paul 1981) 62 and 63.

105 BOE 5 June 2013, no 134, 42244.

106 See, as examples, Act 22/2007, 11 July, on distance financial contracts (BOE 12 July 2007, no 166, 29985); or Act 47/2007, 19 December (BOE 20 December 2007, no 304, 52335) on the transposition of the MiFID Directive. Even the Spanish legislator did not take advantage of the possibility given in EU Directive 2008/48/CE of the European

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in Order EHA/2899/2011[107] to avoid future bad banking practices do not appear sufficient to avoid future bad banking practice and do not add anything extra to the current situation. Indeed, there are no specific legal consequences for misbehaviour by lenders in the marketing and pre-contractual phases, such as the failure to properly assess the capability of the debtor to repay the offered mortgage or the failure to disclose sufficient information to the debtor so that he or she is able understand the cost and the legal and economic consequences of the legal documentation he or she is about to sign. Nor are there any legal consequences from this upon the loan contract. There is a simple administrative fine in Article 14, but this does not in any way lead to the possible invalidity of the loan contract or any type of contractual or torts liability on the lender. Moreover, the rules in this Order do not create greater obligations for those who take part in the standard process of granting a mortgage loan. For instance, there is no compulsion on a notary public to check for the validity of all type of pre-formatted and pre-included clauses in the loan contract, or to forbid excessively onerous mortgage loans. Indeed, the functioning of the Latin notarial system in Spain is now being questioned.[108] Notary publics in Spain still claim that it is not their duty to assess the position of the parties, although legislation provides that they have to 'inform' or to 'warn' them. But there is no requirement to ensure that they understand the legal and economic consequences of underwriting a mortgage loan. Nor, it is claimed, is it their duty to control the legality of any abusive clauses incorporated into the public deeds unless they had previously been declared void by a judge. This would appear to be a reasonable request, according to Article 83 RDL 1/2007, which provides that if an abusive clause in a contract with consumers is void, this fact must be declared by any person, especially by notaries, which should prevent the registration of that mortgage loan with that clause.

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Parliament and of the Council, of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJEU, 22 May 2008, L 133/66) to extend its scope to mortgage consumers, when it implemented this Directive through Act 16/2011, 24 June (art 3a); BOE 25 June 2011, no 151, 68179.

107 BOE 29 October 2011, no 261, 113242.

108 See, as an example, U Schmid Christoph et al, 'Conveyancing Services Market', ZERP, Study COMP/2006/D3/003 (University of Bremen, December 2007) 77 which establishes that: 'As shown above, most of this regulation, particularly on *numerus clausus*, fixed fees and reserved rights is unacceptable when considered in the light of European competition and internal market law.' Moreover, the STS 16 December 2009 (RJ 2010/702) revealed that lending institutions used to include void clauses in mortgage contracts that had not been properly controlled by notary publics.

In addition to this, in order to resolve previous banking practices, the RDL 6/2012[109] was passed on 9 March 2012. However, its efficacy is very limited. First, the 'good banking practices code' which is proposed as the basic tool for protection of mortgagors is merely voluntary. Second, there are a large number of requirements to be fulfilled by mortgagors in order to qualify for specific solutions to address mortgage default or arrears, such as acquittances, postponement of payments, reduction of interest rates, *datio pro soluto*, etc. Some of these requirements are extremely onerous to achieve, such as the one that states that the whole family of the mortgagor must be unemployed and the loan should not have more guarantees. There is also a limitation to properties within a certain maximum value for the mortgaged property, depending on the size of the city where it is located. The aforementioned Act 1/2013 has recently relaxed the requirements to achieve by debtors and families in need to benefit from RDL 6/2012 but it is still uncertain if this time they will be the adequate to help those that really deserve these special rules.

As a consequence of all this, new and stronger rules are still required to create a comprehensive form of mortgagors' protection, both in relation to the current consequences of reckless past lending and to avoid the negative effects of another housing bubble.

Forthcoming Measures

There are essentially two types of forthcoming measures that are being introduced into the Catalan legal system, thus they will only apply to Catalonia once passed into law. One group of provisions will deal with the necessity to really strengthen the protection of mortgage consumers. Another group of provisions will deal with the fact that new types of housing tenures are needed to augment the housing market, and to adapt it to the economic capabilities of each family, instead of making families to choose between full ownership and renting.

More protection for mortgage consumers

Devolution rules in relation to mortgages are unclear in the decentralized regions of Spain. Despite this, the Catalan legislator has drafted a Law Project to reform the Catalan Consumer Code (CCC) in July 2012,[110] which addresses the main issues in relation to protection of the mortgagor.[111] This reform is inspired in the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property of March 2011[112] and goes beyond any

109 BOE 10 March 2012, no 60, 22492.

110 DOGC 30 July 2012, no 364, 34. Although the Catalan Parliament is to be dissolved because of the calling of an elections, it is foreseeable that this draft will continue to be processed after the elections. If it is passed, it will be in force only in Catalonia.

111 I was, in fact, personally involved in the drafting of its first version in September 2011.

112 Brussels, 31 March 2011, COM(2011) 142 final.

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measures taken until now for the whole of Spain (including many aspects of Act 1/2013). The relevant issues are as follows:

(a) A clear legal limitation (new Article 251-6 CCC) on the rate of interest charged on arrears to be limited to no more than 2.5 times the legal interest rate of money (which is fixed on an annual basis by the Spanish government), regardless of what the parties have arranged in the mortgage contract. Indeed, it is currently usual to find interest rates on arrears of more than 20 per cent in mortgage loan contracts.

(b) The obligation on the professional lender to check the economic capacity of the borrower (consumer) to repay the mortgage loan he or she is offering to him or her. If the lender discovers the unsuitability of that mortgage for a particular borrower, he or she should warn the borrower about its unsuitability (new Article 263-2.3 CCC). Unfortunately, the Catalan reform does not foresee the same strong results as are foreseen in Article 14.2 of the Directive Proposal (at least in its first version of 31 March 2011[113]) in the event of the contravention of this obligation. Under Catalan law, the borrower will be allowed to contract such a mortgage anyway, while in the Directive Proposal, there is a clear prohibition on the lender from granting it. However, the Directive Proposal fails to state the consequences for the lender who grants that inadequate mortgage to the borrower. The natural consequence in many legal jurisdictions would be the voidability of that mortgage loan, which entails a difficult situation for the borrower, who will then be obliged to return an amount of money he or she no longer has. This is not the only case in which the Catalan proposal could have further protected the mortgagor. The defining of the notarial role in the new Article 123-10 CPCC is another. On the one hand, this increases notarial duties in relation to the provision of information to the mortgage consumer in a way in which it can be understandable,[114] while on the other hand, it limits the notarial control to those clauses in mortgage contracts that have been previously declared void by a judge. Instead, it could have expanded the notary's duty to those clauses which are clearly abusive (regardless of

113 But no longer in its version resulting of its adoption by the European Parliament on 10 September 2013 (T7-0341/2013). Its art. 18.5 states that: "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" while art. 14.2 of the Project at 31 March 2011 stated that: "Member States shall ensure the following: (a) Where the assessment of the consumer's creditworthiness results in a negative prospect for his ability to repay the credit over the lifetime of the credit agreement, the creditor refuses credit", which at least seems a more expedited wording.

114 This is essential because simply providing long lists of information is not enough, especially for financial products. See the discussion above about the dubious efficacy of the 'long lists' system to protect consumers that is normally used in European Directives.

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whether they have been previously declared void by a judge) in Article 83 RDL 1/2007.

(c) Pre-contractual clear information for mortgagors is required in the marketing phase of the contractual path (new Articles 262-3 and 262-4 CPCC). For example, when the law is passed, the following sentence will be compulsory in each advertisement for a mortgage product: 'Contracting this mortgage may cause you to lose your dwelling and a part of your personal estate.' After the marketing phase, but before the contract is signed, the offer by the professional lender should be incorporated and given to the mortgagor in a pre-formatted form, which should be the same for every professional lender. This application form should be formatted in such a way that it discloses the grounds for the final price of the mortgage loan (i.e. to which extent swaps, caps, floors, insurances and other linked financial products influence the final interest rate of the mortgage loan and its other conditions). Only then will the mortgage borrower have the sufficient information to be able to compare this particular offer with other offers from the same or another professional lender – this is what is needed by every consumer.

New Forms of Housing Tenure – The Catalan Intermediate Tenures

Justification

The measures described above would improve the current situation and would avoid repeating the mistakes of the last 15 years in relation to housing and the mortgage markets. However, they do not, in fact, create anything new, and there is really a need for imaginative measures to overcome the current situation and to re-start both markets.

Intermediate tenures can play an important role here. The Directive Proposal 2011, as was mentioned previously, will no longer allow lending institutions to grant subprime mortgages, which would mean, in practice, that the maximum LTV would, in a best-case scenario, amount to no more than 80 per cent. If this is passed in this or in a similar way[115], it will bring a completely new set of rules to play in the Spanish mortgage market, as it would essentially mean that lending institutions would only be allowed to fund 80 per cent of the value of the house. The other 20 per cent should be paid by the buyer upfront. Numerically, this would mean that for a flat valued at €150,000,[116] the mortgagor would have to pay

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115 As said, this seems to have been somehow softened by its version of 10 September 2013, although member states should control anyhow that no more careless lending is undertaken by lending institutions.

116 This is nearly the medium price for a 80m^2 dwelling in Spain according to fotocase.es http://www.fotocasa.es/indice-inmobiliario__fotocasa.aspx accessed 19 October 2012.

€30,000 upfront in cash, quite a large amount for many. In effect, this might mean that many families will never be able to become home-owners[117].

One significant initiative[118] that is being developed in Catalonia[119] is the regulation of intermediate tenures,[120] based on the success of the shared-ownership model in the UK,[121] and the work of housing associations there in developing social housing on this basis. The UK shared-ownership model is based on the device of the leasehold, an approach conceived under common law that is unknown in many civil law jurisdictions.[122]

That is why, under Catalan law, the proposal is to differentiate between 'shared ownership' (*propietat compartida*) and 'temporal ownership' (*propietat temporal*). The using of the word 'ownership' is crucial to differentiate these two forms of tenure from limited real rights – traditionally not an attractive option for either consumers or financers to access a dwelling. This proposal clearly points out that they are two new alternative ways to the 'traditional ownership'[123] (*propietat*) of achieving all faculties of the full ownership – step by step in shared ownership and time-framed in temporal ownership.

This approach is conceived, in fact, as a middle way between ownership and renting, and is intended to create a real third housing market, which will lead to a viable alternative for families to achieve a type of housing tenure which is

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117 The only remaining option being to rent, and it has already addressed the issues in relation to this type of tenancy in Spain.

118 By the Housing Research Group of University Rovira i Virgili, Tarragona, Spain http://www.urv.cat/grups_recerca/housing/english/RGAH/Welcome.html accessed 19 July 2013.

119 The proposal is currently under consideration in the Catalan Codification Commission in order to introduce the intermediate tenures into the Catalan Civil Code.

120 As mentioned in note 1, this work belongs to a Project of the Spanish Ministry of Economy and Competitiveness to expand the intermediate tenures to the rest of Spain.

121 See a complete study on economic aspects of intermediate tenures in Sarah Monk and Christine Whitehead, *Making Housing More Affordable: The Role of Intermediate Tenures* (Oxford, Wiley-Blackwell 2010).

122 Although as Jane Ball in 'Fragmentando la propiedad para la asequibilidad: la shared ownership o 'nuevas' tenencias en Inglaterra y Francia' in Sergio Nasarre-Aznar (ed), *El acceso a la vivienda en un context de crisis* (Madrid, Edisofer 2011) 173 states, 'there might exist similar institutions in Continental Europe, such as the emphyteusis or the usufruct. However, they do not achieve the grade of "utility" or "usability" as the leasehold, as they are not ownership-like institutions but only rights in *re aliena*, which are quite limited in their scope'.

123 This 'traditional ownership' date from the French Revolution and entails all rights of use and disposal (*usus, fructus et abusus*) in relation to a thing. It is present both in the Spanish Civil Code (art 348 CC) and in the Catalan Civil Code (art 541-1 CCC). Both are constitutionally palliated (i.e. those faculties within the ownership are limited) by their social function (e.g. someone cannot destroy their own thing if this affects another's fundamental rights, and nobody is allowed to exploit a property if, in doing so, it affects another's fundamental rights).

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Table 2.2 Goals to achieve the Catalan intermediate tenures

Ideal goals of housing policies according to the current situation	**Shared ownership**	**Temporal ownership**
To reduce the vacant housing stock and to reactivate the housing and mortgage market	Allows the sale of portion of ownership of dwellings instead of complete title of dwellings (that are not being sold today anyway)	Allows the sale of dwellings for periods of time, adapted to the needs of each family
To reduce the financial illiquidity of financial institutions	Loans of smaller amounts: this will depend on the percentage of the acquired share of the property	Loans of smaller amounts: this will depend on how long the buyer has the property
To prevent families from becoming over-indebted	To grant smaller and more sustainable mortgage loans. Investment in housing will be more needs-based, relying somewhat on savings rather than borrowing	
To create a favourable context for responsible lending and borrowing	Progressive acquisition of home-ownership (staircasing)	Real necessity to buy a dwelling based on time limits. This type of tenure clearly goes against speculative operations
To allow flexibility of approaches in access to a dwelling	A continuum in the form of housing tenure can be achieved; thus, there is one for each type of family need	
To develop stable but flexible tenure	When there is more need for a stable tenure (ex. retirement), the full ownership has been already acquired. In the meantime, there is a clear and progressive investment in one's house	During the tenure, the buyer becomes the true owner of the house. Once the time expires, it returns ex lege to the original owner
In the current context of social housing, today's conjuncture does not allow too onerous intervention in social housing by the public administration	The public administration can limit its intervention to the part of rent of the shared ownership	The public administration can sell real estate and dwellings to families that can be recovered at a certain point in time to be reused (and given to another family in need), refurbished (if it is deteriorated) or rebuilt (if it is in derelict)

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attainable (avoiding over-indebtedness), stable (allowing families to become established, unlike the aforementioned reform of the Spanish law of leases) and flexible (not necessarily tying families to a piece of land for 30 or more years). Intermediate tenures would help to reduce the vacant housing stock, alleviate the need for liquidity for Spanish lending institutions and, ultimately, help families to access to a sustainable and stable home. Table 2.2 shows how this can be achieved through the developing Catalan shared and temporal ownership approach.

*Shared Ownership (*propietat compartida*)*

The shared ownership approach provides the buyer (the shared owner) with a share of the property, while the other share is owned by the seller (the original owner), both coexisting. In other words:

i. The buyer is the (shared) owner of (a part of) the property from the outset. In this sense, this approach differs from others, such as the rental with purchase option (which usually only entails a delay in the purchase for about three years) or rights to build.

ii. The shared owner pays the (shared) seller of the property a rent for the portion of the legal element of the property that the former does not currently own. This, in combination to his or her owned share, entitles him or her to use the whole property in an exclusive way.

iii. This means that shared owners have all the rights related to home-ownership: the exclusive use and enjoyment of the whole property, and the ability to dispose of the share he or she owns, both *inter vivos* and *mortis causa.* As a consequence of this, the shared owner pays all taxes relating to the use and ownership of the house (e.g. utility bills, taxes on home-ownership). He or she can attend the condominium government body and can take part in its decisions.

iv. The shared owner can mortgage his or her share on the property, even for funding his or her acquisition. Of course, a mortgage on 20 per cent of the property (based on the norm under the English shared ownership scheme of five per cent funded by the buyer from his or her own resources, 20 per cent as the first share of acquisition and 75 per cent held by the seller/lessor) is less onerous for the buyer and for the credit institution than a mortgage to fund the acquisition of the whole property.

v. The shared owner has the right to progressively acquire more shares of the ownership of the property (staircase up). In social housing, the scheme would also offer the possibility ‘to staircase down’, i.e., the shared owner can reduce his/her share of the property in accordance to his housing and economic needs.

Thus, the shared ownership approach has been designed to give those in need of housing and those that cannot buy a property in the private home-ownership market

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the possibility to own (step by step) a house without becoming over-indebted. The shared owners (buyers) are granted all powers necessary to act as full owners of the property, although with certain limitations to protect the interests of the seller (who is retaining, in our example, 75 per cent of the property), and the eventual financer of the acquisition. Of course, the buyer in a shared-ownership scheme cannot alter the substance of the property, and he or she must use it for the agreed purpose (e.g. residence in case of social housing) and cannot alter its structural elements.

*Temporal Ownership (*propietat temporal*)*

There is also temporal ownership, where a new owner acquires the ownership from an original owner of a property, but only for a certain and determined period of time. During this time, he or she has all the powers on the property (use, enjoyment, disposal *inter vivos* and *mortis causa* and charge – e.g. with a mortgage to acquire the temporal ownership), as he or she is considered a 'temporal owner'. For this same reason, the temporal owner will be responsible for all expenses related to the property.

This approach differs substantially from the current system, where a property is acquired 'forever' (i.e. eternally) under Spanish and Catalan laws. The introduction of 'temporal ownership' will allow the purchase of a property for a specified number of years. This entails important stability for the buyer and significantly increases its affordability. After this specified number of years, the ownership of the property will revert automatically and without cost to the original owner (the seller), unless extensions are agreed. The original owner is entitled to be compensated for all depreciation of the property caused by the negligent or wilful misconduct of the temporary owner.

This temporal ownership approach may provide a solution to a variety of situations, given that its duration may be decades or hundreds of years in length. Moreover, it is foreseen that it can be used in combination with shared ownership, thus increasing the fragmentation and the affordability of the available housing stock in the same way as the leasehold is used in combination with shared ownership in the UK.

Conclusions

It is now widely accepted that the current global financial, economic, mortgage and housing crisis started in the US in 2007. The origins of the US crisis can also be explained as a consequence of severe deficiencies in the legal architecture and institutions. It is difficult to understand how a market of several trillion US dollars could effectively operate without a specific piece of legislation covering the rights and obligations of the parties, or how mortgages could be effectively recorded and verified through more than 3,000 land registers, or how these could have been

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properly and efficiently transferred fulfilling traditional rules of common law, or how they could be properly enforced in non-recourse states, or in those states with only judicial enforcement procedures. Only in this context can we understand the misbehaviour of the rating agencies, the existence of structural problems in a standard US mortgage securitization process, or the creation of MERS. The US crisis spread to Europe and to the rest of the world due to the international mortgage securitization of US subprime mortgages through MBSs and CDOs. This created a 'lack of trust' crisis among credit and investment institutions globally, from which many countries have not yet recovered. Some countries, such as Spain, are in an even deeper crisis due to a variety of factors, but fundamentally due to the high dependence of their economy in recent years on housing construction.

Spain's current situation is a result of a range of factors that have led to a housing bubble and its subsequent bursting. Among these are the widespread existence of mortgage loans, now acting in detriment to other more affordable types of housing tenure, the inadequate regulation of the mortgage and banking operations, the lack of sufficient protection for mortgagors and bad banking practices. The measures undertaken in reaction to the crisis by the Spanish government to date have been insufficient. However, new measures involving increased protection for mortgagors are being considered by Catalan legislators, which deal with some bad banking practices and abuses, and also with the lack of sufficient and effective pre-contractual information. There are also some innovative approaches being developed, which seek to create a third type of housing market (in addition to the two classic ones: home-ownership and renting) and which have the potential to reinvigorate the housing and the mortgage market systems in Spain. These are the so-called 'intermediate tenures', which in Catalonia are being adopted in the forms of shared and temporal ownership. Clearly, in the face of the global and local economic collapse which relied on many outdated and inadequate legal structures and regulatory mechanisms, new and innovative legal approaches are now required more than ever in relation to housing.

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